Accounting harmonisation and the case of French use of the true and fair view.

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Abstract

The literature which identifies national differences in accounting and addresses the problems of harmonisation is reviewed and consideration given to how this interacts with theories of accounting change. It is suggested that harmonisation attempts will be modified by the interplay of competing interests in each jurisdiction.

The nature of the true and fair view in its British context is also reviewed and found to be a flexible notion whose use may serve a number of interests. Its adoption process of the European Community Fourth Company Law Directive is considered. French accounting since 1945 is analysed and consideration given to the influences which were active in accounting during the period of adaptation of French accounting in compliance with the Fourth Directive.

The changes brought about in French accounting are considered as well as the French understanding of the true and fair view. Two empirical studies address the evidence of change after adoption. A study of recognition of excess tax depreciation in a sample of 50 published annual reports shows that a majority of companies changed their measurement approach. A second study sets out to observe whether the true and fair view as operationalised in the preparation of accounting statements from artificial data would be similar as between France and Britain. The study suggests that there are differences but these are as great between accountants within each national group as between the groups.

It is concluded that the revision to French accounting provided an opportunity for the accounting profession and large enterprises to move towards an approach which served their interests. This involved freeing accounting from the domination of tax-driven measurement, and was

only partly successful. The outcome is a compromise which provides accounts superficially similar to British ones but with substantial measurement issues still to be addressed. The French experience suggests that the process of harmonisation is a political one where external intervention simply provides an occasion for established interests to assert themselves.

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CHAPTER I

Introduction

A central objective of the European Community when it was founded in 1957 was the establishment of a free market within the Community. In practical terms, the Community has taken the view that included within this objective is freedom of establishment of businesses throughout the Community. In turn, it was considered that the creation of a harmonised company law regime was necessary to achieve this (Ernst & Whinney [1979], Coleman [1984], van Hulle [1986]).

The European Commission therefore created a programme of company law harmonisation which included Directives to member states on the form and content of corporate reports. In particular, the Fourth Company Law Directive prescribed the format of individual company accounts, specified some basic principles and established the true and fair view as the over-riding objective of the accounts.

Harmonisation of accounting is a costly process. In the first instance the years spent in preparing a company law Directive involve considerable resources both from the European Commission and from the bodies involved in commenting upon and working upon drafts. Once adopted by the Council of Ministers the Directives have then to be implemented by each member state. They may bring about changes in each country's national legislation which in the case of major measures such as the Fourth Directive then trigger massive costs in the accounting and business community to train staff, change systems and so on.

The economic consequences of the harmonisation process are very considerable, even before one starts to address the consequences which arise after the new accounting is operationalised and reaches users. Given the costs, it seems valid to examine the process to attempt to throw some light on the question of whether a real change in accounting and move towards greater similarity of accounting within the Community are achieved.

The regulatory process

The process by which the Fourth Directive came to be drafted offers an interesting example of accounting regulation. The Commission might have set out to draft its requirements by first establishing a conceptual framework which would have made overt the objectives of its accounting, from which it could have proceeded to create regulations (Carsberg [1984], Bromwich [1985]). However, this approach was not used – a discussion paper was prepared which proposed a model based essentially on extant West German legislation. The process, which started in 1966 and ended only in 1978, involved political negotiation in a series of different forums to arrive at a compromise, based largely upon grafting a British formula, the true and fair view, onto a German format (Nobes [1986]).

The compromise version had then to be implemented by each member state. The adoption of an EC Directive within a member state offers an opportunity to observe the forces which cause accounting change as they react to the obligatory import. The Fourth Directive omitted to define the true and fair view and created a situation where individual member states would be obliged to operationalise it independently. For research purposes a focus on the true and fair view appears to offer the most fruitful opportunity for study since it is open to interpretation and allows competing interests to express interpretations which best serve them.

In as far as the formula is imprecise and undefined and was developed in a common law environment, it might have been expected to pose particular problems for jurisdictions where the regulatory framework operates through detailed code law. France, within the Community the country perhaps most dependent upon code law, commenced its adoption of the Fourth Directive rapidly, producing draft accounting requirements in 1979 and enacting a new accounting law in 1983. Financial statements for the year commencing 1st. January 1984 were the first to be produced in France as giving what is regarded as a true and fair view of companies (Nobes and Parker [1985], Walton and Scheid [1987]).

Predicted outcomes of harmonisation

There are many critics of harmonisation both in terms of the extent to which harmonisation is feasible and whether it is desirable. Such critics put forward a number of objections which would suggest that the outcomes of a harmonisation attempt would be at best flawed. Arguments put forward include the observation (Choi and Bavishi [1983]) that harmonisers often concentrate on disclosure and ignore measurement differences. Others observe that within the European Community the emphasis which is traditionally placed on different uses and users of accounting varies from country to country (Busse von Colbe [1983]) while in adopting Directives member states typically graft new legislation onto their existing requirements (Burgraaf [1983]) rather than abandoning the original approach. It may also be that within each country the process of adoption, taken as an example of the process of accounting change, is likely to provide an opportunity for further political manouvering as the influences which shape accounting nationally come in to play (Zeff [1972], Burchell, Clubb and Hopwood [1985]). This may result in the national version straying from the Community original.

The example of the adoption of the Fourth Directive by France offers an opportunity to observe to what extent these prognostications are borne out in practice. The study focuses on the true and fair view since this is identifiably an import into continental European members of the Community, so its progression can be traced; it is adopted as the over-riding objective of Fourth Directive accounting, so must be addressed by member states; and the true and fair view is so indeterminate in its nature (Chastney [1975], Rutherford [1984]) that it allows flexibility in interpretation, therefore national differences may be more discernible in their adoption of that than in relation to some more concrete area such as balance sheet layout. From a British perspective there is a secondary interest in that, having exported the true and fair view to the Community, British accountants may well be obliged to modify their use of it to comply with its interpretation in the Community.

Britain has a tradition of exporting the true and fair view (Parker [forthcoming], Walton [1986]) but typically this has been as part of a package of company law and in a Commonwealth context. Its adoption by the European Community offers an example of export where the true and fair view is not part of a cultural package and is therefore more likely to be questioned more closely and adapted. At the same time, there is little precedent in law and no agreed definition amongst accountants in Britain as to what the formula means or what purpose it serves. It is possible that its very lack of definition makes it easier to import, since it can be adapted by the importer.

This study focusses on the true and fair view as an example of harmonisation in action. It follows the true and fair view through the process of incorporation into the Fourth Directive and then adoption by France, in order to address the issues of whether harmonisation achieves change which would not otherwise have happened, whether the change produced reflects what the Commission intended, whether the accounting reports which are produced give a different picture from that given prior to harmonisation, and whether the picture given is close to that in another post-harmonisation environment.

The study will proceed in the following way: first it will review the literature which is concerned with harmonisation and the process of accounting change to establish the framework against which the Fourth Directive was created. Then it will consider the true and fair view, how it operates in Britain and what accountants perceive it to mean. Next, using both published sources and material obtained by interviews with individuals involved in the process, it will trace the adoption of the true and fair view by the European Commission and analyse what was understood by the formula in that context.

The study will then move to the French adoption of the Directive, looking at the history of accounting and the influences which have shaped it since 1945, and then the reactions to adoption and what French accountants perceived true and fair to mean. This is followed by an empirical section which asks (a) whether adoption of the Fourth Directive brought about a change in measurement and (b) whether, provided with the same data, British and French accountants produce similar true and fair views.

CHAPTER II

On classifying and reducing accounting differences

This first part of the study is concerned with establishing what insights, if any, into the probable difficulties and outcomes of harmonisation may be gained from the accounting literature, and creating a notional model from which to predict the results of the harmonisation process in the particular case of France and the British true and fair view.

Although the motivations which fuel harmonisation initiatives may be diverse, the objective of harmonisation is ordinarily to reduce accounting differences between jurisdictions. A first step in reviewing a particular example of harmonisation, therefore, is to identify the differences which are to be reduced, and approach to this may be obtained by a review of the literature which has sought to classify national accounting practices and explain the sources of accounting differences.

This chapter sets out to locate French and British practices in relation both to each other and other members of the European Community. In order to identify the obstacles to reducing differences it examines whether there is support for the notion that accounting differences derive from institutional and environmental factors and are systematic in their nature. Contrasted with this is the growing body of literature which suggests that accounting change is not systematic but occurs in response to pressures which arise in relation to individual issues, leading to national differences which are to an extent a chance accumulation of historical events.

Following on from this, the study analyses the nature of major interest groups which are likely to attempt to influence accounting regulation, and reviews the literature which specifically addresses harmonisation issues, in order to build a conceptual model for the harmonisation process in general and the specific adoption by the French of the British true and fair view.

Classification Studies

A logical starting point in identifying accounting differences is the work of researchers who have attempted to classify different national accounting practices. If researchers were able to identify national differences and their causes this would be one means of establishing the obstacles to be overcome or the most efficient lines along which to proceed in a harmonisation attempt. However, if researchers were able to identify causes in an unambiguous manner, this would suggest that the development of accounting within each environment was a relatively simple process. In fact much of the literature on accounting change (Zeff [1972], [1978], Watts & Zimmerman [1978], [1979], Burchell, Clubb & Hopwood [1985], Hopwood [1987], Bromwich [1985]) suggests that this is far from being the case.

Although Watts & Zimmerman on the one hand and Burchell, Clubb and Hopwood on the other argue from different points of view, all would agree that when a particular accounting issue comes to be debated in the standard-setting forum, a number of interested parties will come forward to attempt to influence the debate. However, the identities of the interested parties may change as the accounting issue changes: for example only companies with extensive foreign operations will have an interest in debates on currency translation accounting; retailers will have no interest in accounting for mineral reserves etc.

Viewed from this perspective the classification of comparative national practices becomes very restricted – if the factors which shape accounting are changing there can be no effective way of identifying them to create a detailed predictive model and the end results of the process in each country will not produce systematic differences with other countries except at a very general level. However, establishing comparative differences at that general level is a useful first step towards establishing the framework within which the true and fair view was exported from Britain to France.

Classification has been pursued with rather variable results since the initial attempts made by Mueller [1967]. Aside from the caveat that the process of creating accounting practices in any country is a dynamic one and at any given moment the mass of generally accepted accounting principles (gaap) will be built up of an accumulation of outcomes of past compromises between interested parties, the major research problem encountered by classification studies is how to identify and then to measure the criteria which could be used to distinguish one set of practices from another. For example, should researchers start by looking at published financial statements and attempt to make comparisons between similar companies in different countries ? Alternatively, should they look at accounting practices ? If the latter route is taken, how do they select which are the more important, and are details of the practices available for measurement ? Are researchers entitled to make the assumption that gaap are applied uniformly by all practitioners within the same jurisdiction ? What authoritative source material is available to describe practices and is the language of the description free of nuance ?

In broad terms classifications can be divided into two camps based on the method of resolving the problem. One group have chosen to identify environmental factors which might influence accounting, and assign individual countries to groupings based on personal judgement. The other group has looked to statistical analysis based on published summaries of accounting practices.

Judgemental classifications

Mueller [1967] first suggested an approach to classification which was based on the existence of four 'core' patterns of development of accounting in Western nations with market oriented economies: (a) accounting within a macro-economic framework; (b) micro-economic approach; (c) accounting as an independent discipline; (d) uniform accounting.

Under the macro-economic approach, measurement of firm performance was linked to national economic planning and performance assessment. Mueller quotes the creation of investment reserves in Swedish companies as an example of an accounting technique derived from national economic planning rather than measurement of profit for shareholders. By micro-economic approach he meant that accounting was a tool of micro-economics and should measure the performance of the individual firm by measuring increases and decreases in real capital. Such an approach leads to accounting using replacement cost, and Mueller offers some firms in the Netherlands as an example.

His third category, independent discipline, encompasses environments where accounting has developed alongside business, responding pragmatically to the needs of business for measurements, and developing new practices by extending the old base as business develops. Mueller cites the United Kingdom and United States as the prime examples. Finally uniform accounting occurs where accounting is seen as the scientific application of a measurement system which typically does not permit any alternative approaches. Mueller observes that such a system may be intended as a basis for tax or for national economic measurement.

Mueller's uniform accounting category is different in nature from the other three categories: it describes a measurement method where the other three describe conceptual starting points. As such it could be applied to any of the other three without necessarily changing the underlying approach (although the reason for the existence of a uniform system might have conceptual implications if, for example, the uniform approach was being enforced by the state to satisfy its own purposes).

The identification of patterns of development may be useful in analysing factors which are brought in to play in the course of the development of accounting, but there is a danger in Mueller's approach that it implies that countries are likely to fall into one category or the other, whereas it is probable that gaap in any one country at any one time reflect elements of all these influences as well as others. For example, within macro-economic development Mueller takes the relationship of accounting with the State as being concerned with economic planning, while disregarding other influences from other parts of the State, such as tax collection (see Miller [forthcoming]).

Mueller's initial classification was shortly followed by a more elaborate one based on an assessment of the business environment (Mueller [1968]). The new classification was based on the idea that the accounting system of a country was embedded in its business environment and that there were four 'marks of separation' which could be used to identify significantly different environments which should therefore provide different accountings: (1) state of economic development; (2) stage of business complexity; (3) shades of political persuasion; (4) reliance on some particular system of law.

In this approach Mueller seems to be abandoning his earlier ideas, in particular the role of the State in influencing measurement. At the same time he is broadening his focus to the extent that his 1967 study was directed only at Western developed nations, whereas his 1968 study aims to take in criteria which go beyond capitalist economies. His 'state of economic development' therefore takes in the possibility of undeveloped countries, countries which are not market oriented, and less developed countries. 'stage of business complexity' also reflects this in that he notes problems such as accounting for research and development tend only to occur in more sophisticated businesses.

His 'shades of political persuasion' is explained on the basis that different political environments have different attitudes to property, though he does also mention that social legislation may affect business environments directly. Finally he identifies reliance upon a particular system of law, citing differences between common law and code law but also noting that different countries have differing attitudes to the degree of freedom which business should be allowed to enjoy.

It is not clear that this analysis advances understanding of international differences very far, beyond dealing with some fairly basic ideas such as that accounting needs in an undeveloped economy are likely to be different from those in a Communist country and those in a developed market economy. Although focussing on the business environment as the determinant of different accountings, Mueller does not explicitly mention users of accounts, the capital market, or potential interest groups such as trade unions, accountants etc. He is the first to raise the question of the influence of a different legal environment, but focuses on the question of code law versus common law. This may be an over-simplification since it may be that attitudes to and expectations of the legal environment are more significant than the actual mechanics: if auditors prefer detailed regulation this can be provided within a common law background as happens in the US, whereas indeterminate formulae can be found in code law systems, such as regularity and sincerity in French accounting.

Using his four marks of separation in relation to his own understanding and experience Mueller identified ten distinct sets of business environments: (1) United States/Canada/The Netherlands (highly developed businesses, minimal company legislation); (2) British Commonwealth excluding Canada (common core of company legislation, business highly developed but traditional); (3) Germany/Japan (rapid post-war economic growth, strong US influence, appearance of new class of business managers) (4) Continental Europe excluding Germany, The Netherlands and Scandinavia (lack of government support for business, private property and profit not necessarily centre of business orientation); (5) Scandinavia (slow rate of development, social legislation); (6) Israel/Mexico (rapid economic development, significant government involvement in business); (7) South America (under-developed, soft currencies, military interests dominate government); (8) developing nations in the Near and Far East (business dominated by West, underdeveloped); (9) Africa excluding S. Africa (little or no native business environment); (10) Communist Nations (complete control by central government).

This classification demonstrates all the problems of this kind of research: it can only relate to a particular moment (for example in the late 1980's it is not so obvious that Germany and Japan are strongly influenced by the US); it makes wild generalisations (all continental European countries, excluding Germany and Scandinavia, in one group which is described as having little governmental support: in France many of the largest undertakings are state-owned and have been since 1945 etc.); and it insists upon allocating countries to mutually-exclusive groups, forcing an over-simplification.

Based on the superficial nature of the analysis, it is difficult to see what use this classification may be. If, as Mueller asserts, the business environment as he identifies it within this system is what determines accounting in these countries, we should be able to assert that, for example, Italy and France must have similar accounting (although Italy has still not been able to adopt the Fourth Directive because of the degree of change required) or indeed that Antigua as a Commonwealth member will have similar accounting to (say) Australia (Antigua's company legislation is a replica of the UK 1862 Companies Act).

However, while accepting that the classification is 'completely subjective and non-hierarchical', Mueller asserts (Choi & Mueller [1984]) that it was 'utilized widely by national institutes of accountants, various international organizations, and multinational professional accounting service firms'. This would imply that Mueller's conclusions were found intuitively appealing at least by others with accounting dealings across national boundaries.

In the 1970's a number of further attempts were made by other researchers to identify characteristics or environmental conditions which distinguished different countries or groups but which they did not elaborate into actual classifications. These will be considered in the next section. However in 1977 an American Accounting Association committee (AAA [1977]) produced a classification based on (five) 'zones of influence': (1) British; (2) Franco-Spanish-Portuguese; (3) Germanic-Dutch; (4) United States; (5) Communistic.

These were identified in the course of a study whose object was to analyse accounting in developing countries. It was 'based on historical-cultural-socioeconomic sources which have influenced accounting principles underlying financial measurement and reporting in different countries and regions'. The Committee did not elaborate on its classification, taking the view that this would involve extending its own brief far beyond its original limits. The presumed implication of this approach in as far as it bears upon European harmonisation is that the AAA Committee evidently saw the influence of the three European zones of influence as significantly different from each other.

Since the Committee did not provide any detailed rationale for its selection there is little more than can be drawn from the classification. Interestingly the Committee did note: 'while generally the sources of influence of acconting are known, the identification of characteristics of "sources of influence" in developing countries is less clear, due to stages of development and influences the countries may have gone through'. This seems useful in acknowledging the dynamic element and the accumulation of accounting principles over time as important features which defy the urge to classify.

To date the most elaborate classification based on subjective evaluation is that of Nobes (Nobes and Parker [1981],[1985] and Nobes [1984], [1986]) which attempts a more hierarchical classification into groups and sub-groups and 'tries to show not only that two particular countries are in different categories but how close or distant these categories are'. Although conceived initially as a result of a literature search and extensive interviewing, the Nobes classification was later (Nobes [1984]) subjected to statistical testing.

The Nobes classification takes the view that a major distinction can be seen between countries whose accounting has a macro-uniform orientation, and those which are oriented towards measuring individual company performance using pragmatically developed accountings. This is more intuitively appealing than Mueller's 1968 classification where no comparison is made between groups, although it is open to the criticism that it identifies one major grouping, that of Anglo-Saxon accounting where both British and American accounting can be seen to share many strands, and artificially creates a second major grouping which might be labelled 'systems determined under direct Government control'.

The countries in this major grouping do not necessarily have accountings which relate to each other in the same way as those in the Anglo-Saxon grouping. It might be argued that what the macro-uniform group countries have in common is that their accountings are controlled by state organisations, although the perceived objects of the accounting may be different, while in the Anglo-Saxon group the common factor is that the objects are the same but the method of control is different.

It is doubtful that Nobes' classification goes much further than Mueller's at second sight. Both classifications suffer from perhaps trying to classify what is inherently unclassifiable and can operate therefore only at the most general level. In terms of throwing light on the likely difficulties to be expected in a harmonisation project they confirm that at a superficial level Britain and France fall into different categories, and in relation to the Community as a whole, different members such as Germany, the Netherlands and Denmark are in yet more different categories.

Statistical classifications

The alternative classification studies are typically based on a search for statistically significant correlations of accounting practices. These studies all use data contained in surveys of international accounting practices published by Price Waterhouse in 1973, 1975 and 1979 which surveyed 38, 46 and 64 countries respectively. The survey, compiled from responses to a questionnaire completed by local offices of Price Waterhouse in the countries concerned, scores measurement and disclosure practices across 7 categories (1973:6) between 'no application' and 'required', taking in 'not permitted', 'not found in practice', 'minority practice', 'about half', and 'majority practice'.

The Price Waterhouse data has been criticised (Nobes [1984]) both for specific inaccuracies and for a general bias inherent in the method since it is argued that questionnaire respondents sometimes give the answer they believe the researcher wants, or the answer they believe is 'right' as opposed to an answer which relates exclusively to their observation of data. It is also pointed out that Price Waterhouse partners (a) do not necessarily see a representative sample of clients and (b) have typically been themselves steeped in Anglo-Saxon accounting practices.

The first statistical classification (Da Costa, Bourgeois and Lawson [1978]) was based on the Price Waterhouse 1973 data but limited to

100 practices. The authors argued that the accounting literature of the time identified three major models: the American, the British and the French, (e.g. Seidler [1967]) and then set out to test for evidence to support the existence of the models. Their method was to allocate scores to the Price Waterhouse survey responses (1 = not permitted or not found, through to 5 = required or conventional practice) and then establish groupings of highly correlated practices. They then carried out a principal components factor analysis and finally derived groupings based on similarities in relation to these factors.

In the event they derived two groups only: group 1 included the United States, Germany, France, Chile, Argentina, Sweden and India, while group 2 was the United Kingdom together with 9 Commonwealth or former Commonwealth countries. As Samuels and Piper [1985] remark: it was 'an interesting example of the use of the research technique, but the authors have problems explaining their results'. The authors claim some support from their study for the notions of US and British models, but this is difficult to sustain when they claim a clear Commonwealth group while their 'US' group includes Pakistan and India, and the inclusion within the US group of all the continental European countries. A possible source of difficulty is their selection of practices, and also the assignment of numerical scores to the data.

Nobes [1984] has observed that the statistical package used could only handle 100 variables and this may have imposed an artificial constraint. The authors merely remark that they eliminated practices which were uniform across the sample countries. The scoring of responses implied that the evaluation of the interval between 'required' and 'majority practice' should be the same as between 'majority practice' and 'followed by about half reporting companies'. It might be argued that, from a judgemental viewpoint, there is little difference between the first two but a relevant difference between the second two.

Frank [1979] used the same data but included all 233 practices contained in the survey. He scored the survey responses as follows:

Required	100%
Majority practice	75%
Used by 50% of firms	50%
Minority practice	25%
Prohibited/non applicable	0%

He then subjected the observations to factor analysis and emerged with four factors which accounted for approximately 65% of the variance of the data. Countries were then allocated to a grouping which reflected the factor with which they had the highest score. This produced four groupings which he designated: (i) British Commonwealth Model; (ii) Latin American Model; (iii) Continental European Model and (iv) United States Model. France was classified in the Continental European group, Britain in the Commonwealth group. Frank applied multi-dimensional scaling as an alternative technique and produced the same results.

He also attempted to test the hypothesis put forward by Choi and Mueller [1978] that various environmental conditions can explain differences between accountings. He used a number of variables including official language (as a surrogate for cultural ties), economic variables selected to reflect structure, and variables to reflect trade links and subjected these to discriminant analysis in relation to his four accounting groupings. He identified six discriminant functions: (1) use of the English language, (2) relative proportion of imports from Commonwealth group countries, (3) consumption as a fraction of GNP, (4) use of French language, (5) exports to US group countries and (6) average annual change in exchange rate. 83% of the countries could be assigned to one of the four groupings using these discriminant functions.

Although it is an interesting way of approaching the question of classification, it can only be regarded as a preliminary work in that (a) the groupings proposed are extremely wide, and (b) the discriminant factors identified in the second part of the exercise are relatively crude. The research does not shed any new light except in that it confirms that statistical analysis supports the very general framework which had been derived intuitively.

Nair and Frank [1980] took Frank's statistical analysis further by separating out measurement practices from disclosure practices and by using the results of the Price Waterhouse 1975 survey in addition to the 1973 set. They took the view that measurement practices and disclosure practices were not necessarily worked out in the same way in each jurisdiction: for example in the UK disclosures are largely required through company law, whereas measurement is left largely to the profession and the Accounting Standards Committee. Also they noted that measurement practices tend to be applicable to all businesses, while disclosure requirements are often linked to size, capital market or other criteria.

Using measurement practices from the 1973 survey the authors carried out factor analysis from which they derived four groupings based on each country being assigned to the factor in which it scored highest, confirming Frank [1979]:

Group I	British Commonwealth Model
Group II	Latin American model
Group III	Continental European model
Group IV	United States model

However, using the same technique for disclosure practices they found seven groups, although two of these were single countries (Sweden and Switzerland). The United States and United Kingdom groupings remained stable, but the continental European and Latin American groupings re-formed with, for example, Germany, Japan, Bolivia and Peru forming a new grouping with 'no ready intuitive identification'. France remained clustered with Belgium, Italy and Spain in a group which was joined by Brazil, Paraguay, and Colombia.

The regroupings under disclosure practices seems to provide some support for the idea that different factors may come in to play in different accounting issues within the same jurisdiction, but at an intuitive level the linking of France with (say) Paraguay suggests that statistical analysis has little or no explanatory power on this context. The survey provides support for the idea that, in the context of harmonisation, any marriage between France, Germany and Britain will involve combining dissimilar accounting environments.

Using the same statistical techniques the authors carried out an analysis of the 1975 survey. Under measurement practices they found that compared with the 1973 results Chile moved out to form a single country group and Spain, Italy and Greece moved into the

Latin American model. Disclosure practices revealed seven groupings, also not quite the same as for the 1973 survey. Notably the continental Europe model broke up again but also the Commonwealth group was also regrouped.

The Nair and Frank [1980] analysis comes to the conclusion that 'it is quite apparent that the pattern underlying measurement practices in different countries is quite different from the pattern underlying disclosure practices'. The patterns which are revealed support the idea that there is no uncomplicated set of explanatory factors which work other than at a very general level.

The Price Waterhouse 1979 data was used by Goodrich [1982] to construct further groupings based on statistical analysis. Goodrich recognised five groups, virtually all of which are difficult to explain intuitively. His group II includes Switzerland, Spain, Greece, Paraguay, and Uruguay,; group IV includes Brazil, Norway, India and Australia and therefore it is perhaps no surprise that his group III includes both France and Britain. He says that group III 'is very strong on fair presentation ... many of the accounting principles and policies examined are far less stringently required in this group ... thus the professional organisations in these countries have more freedom and flexibility to interpret the accounts'. Goodrich's findings conflict with the prevailing trend of classifications and on the specific point of accounting in France his comments would be unlikely to be endorsed by the French profession.

The whole concept of classifying international practices must involve over-simplification in terms of restricting the number of contributory factors that can be recognised and in terms of placing countries in a single grouping. It affords only a partial view (Hopwood, Burchell and Clubb [1979]). The different patterns revealed by the Nair and Frank [1980] study when focussing on different areas of practice support the idea that the process by which practice is forged is different from issue to issue and is not capable of meaningful analysis into a scheme of systematic explanatory variables.

However, to the extent that it helps to identify patterns or some contributory factors it affords a starting point for looking at the question of exporting an accounting formula from one jurisdiction to another. In the context of the harmonisation of accounting within the European Community it demonstrates that the individual member states frequently have different practices from each other and that therefore any progress towards harmonisation will require adaptation of practices in individual statesor that harmonisation will be squeezed out by the existing pressures within the member states. The classification studies do not, though, help to reveal just what are the existing pressures within member states.

Determining Factors

Many classification studies have, like Frank [1979] and Nair and Frank [1980], attempted to tie in groupings of national accounting practices with explanatory factors, usually relating to the cultural, social and economic environments. Many accounting authors have reviewed factors influencing accounting in different jurisdictions, sometimes with the object of throwing light on international differences (e.g Mueller [1968] Kollaritsch [1967]) and sometimes, though more rarely, to expose through international comparison the mechanisms by which accounting developments are achieved (e.g. Zeff [1972]).

Many of the studies adopt a rather simplistic stance on the relationship between different accountings and their environment, tending to ignore the way in which accounting may itself shape the environment (Burchell et al [1980], Hopwood [1983]), and assuming that the actors in any individual change are likely to be the same, rather than seeing the cast as potentially changing with the issues (Burchell, Clubb and Hopwood [1985], Watts & Zimmerman [1978]). As with classification there is an underlying assumption that the factors affecting accounting can be (a) identified sufficiently surely as to what they are and (b) as to what effects they have and (c) they are few enough in number to provide a useful analytical framework.

Notwithstanding these limitations, such analyses can be used to establish a consensus of opinion on the major economic and other differences between countries which provide perhaps the backdrop against which dramas of accounting change are played out. They may provide an analytical framework for identifying the infrastructure within the European Community and the major environmental differences between France and Britain.

Mueller [1968] was one of the first in the field with his paper which identified ten groups of countries. He said that accounting 'must respond to the ever-changing needs of society and must reflect the social, political, legal and economic conditions within which it operates. Its meaningfulness depends upon its ability to mirror these conditions'. This would now be regarded as an over-simplification in that it ignores the interaction between accounting and its context (Hopwood [1983]), the use of accounting by interested parties to make visible (or not to make visible) particular aspects of economic activity (e.g. Miller [forthcoming]), and the interests of accountants both as a profession and as pressure groups within the profession (Larson [1977], Willmott [1986]).

Mueller suggested that there were four elements of the business environment which could be used to "explain" different accounting practices. These were:

(1) state of economic development;

(2) stage of business complexity;

(3) shade of political persuasion and

(4) nature of legal system.

Later in the article Mueller expanded his definition of the accounting environment to encompass 12 key circumstances which he believed affected accounting principles:

1. Relative stability of the currency of account;

2. Degree of legislative business interference;

3. Nature of business ownership;

4. Level of sophistication of business management;

5. Differences in size and complexity of business firms;

6. Speed of business innovations;

7. Presence of specific accounting legislation;

8. Stage of economic development;

9. Type of economy involved (i.e. agricultural/service/ industrial);

10. Growing pattern of an economy;

11. Status of professional education and organization;

12. General levels of education and tool processes facilitating accounting.

Mueller has identified the environment as determining accounting, and sees it therefore as the product of needs and ends which it is shaped to serve, but he has limited himself to passive influences and ignored the dynamic, "political" influences which later researchers have observed (e.g Watts and Zimmerman [1978],[1979], Zeff [1978] etc.). Indeed he remarks in the article that 'relative stability appears to be one of the properties of different business environments ... business environments are probably more difficult to change than is sometimes assumed'. He was writing before the oil price shock and the era of floating exchange rates, but it still seems difficult to justify that position even at that time, given, for example, the radical changes in the French economy after the Second World War.

His explanations of what he means by each of the twelve environmental factors now also seem limited. For example his factor (2), the degree of legislative business interference, is limited to a mention of the penetration by tax measurements into accounting, and disregards the possibility of the state use of accounting to make visible the activities it wishes to monitor, or the effects of state economic intervention etc.. Equally his factor 4, the level of sophistication of business management stops short at management's technical needs for information, while the influence of the profession revolves around whether it is sufficiently well resourced to be able to afford its own standard-setting process or must import from elsewhere.

The AAA's 1977 report on international accounting (AAA [1977]) proposed a morphology for comparing accounting systems. This had eight parameters, each parameter being sub-divided into four or five 'states of nature':

P1 political system

P2 economic system

P3 stage of economic development

P4 objectives of financial reporting

P5 source of, or authority for, accounting standards

P6 education, training and licensing

P7 enforcement of ethics and standards

P8 client

The AAA Committee took the view that some sort of classification framework was desirable in order to facilitate comparative analysis of accounting systems. The report was written in the context of studying the accounting of developing countries and the classification framework was intended to enable a developing country to be sited in relation to (say) United States accounting. From this comparison researchers might reach views about how accounting in the developing country could best itself be developed.

It is inherent in this approach that the authors thought that the factors cited were sufficiently powerful in shaping accounting to explain differences in accounting. However, the parameters and the states of nature force a simplification and do not easily permit of a pluralistic approach on any issue. If the AAA morphology is used to compare France and Britain, this will serve to illustrate the problems:

Political system: Both France and Britain would be classified as 'political democracy' – the report specifically identifies the UK in this category and 'other western democracies'.

Economic system: The morphology allows four states of nature: traditional/market/planned market/plan. In this context it is difficult to site France and Britain other than in the 'planned market' state, but the French post-war five year plans, state control of a large sector of industry etc. are suggestive of a higher state involvement than in Britain (e.g. Miller [1986]). This in turn may have lead to a higher state involvement in accounting in France, but this difference would not be captured within this parameter.

Stage of economic development: Both France and Britain would be in the 'mass consumption' state.

Objectives of financial reporting: This parameter allows five states, investment decisions/management performance/social measurement/sector planning and control/national policy objectives. Unfortunately the AAA Report does not provide any further detail about what it wished to convey by these states of nature. It is not clear whether management performance means for internal purposes or for external, though perhaps one should presume internal; no explanation is given of the social measurement objective. By the nature of the classification system only one state of nature can be chosen for each country, and this forces an arbitrary choice since financial reporting rarely if ever has a clearly established single objective. In the UK some standards refer to investment decisions as being the objective of reports but there is not widespread agreement on that, and even if there were, it does not follow that the process of creating standards results in that. As far as France goes there is a history of accounting measurements being strongly influenced by tax considerations (Beeny [1976], Nobes and Parker [1985]) but they are also used for investment decisions (Gray [1980]) so it would be misleading to allocate France to any one state of nature.

Without going in to the remaining four parameters, the above serves to illustrate the point that although the morpohology does address some fundamental points of difference, it can only be used by disregarding the subtleties of each situation, and therefore fails to capture exactly those differences which are of interest. The Report says 'political and economic systems ... are viewed as being pivotal to the type of accounting system which does (or can) emerge and as a constraining influence' and yet applied to Britain and France, they classify them in exactly the same way.

The authors agree that 'some parameters will be relatively more effective than others in clustering and determining closeness of fit ...(but) our committee has not had the opportunity to move the project into its empirical phase'.

More recently Nobes [1984] in conjunction with his suggested classification of national practices also offered a list of six factors which he hypothesises have caused international differences. These are:

1. Legal systems

2. Business Organisation and Ownership

3. Stock Exchanges

4. Taxation

5. The profession

6. Unnatural influences.

A later study by Nobes [1986] develops the 1984 analysis and relates specifically to the European Community, so is the more appropriate focus here. The 1984 causal factors here appear as follows:

1. Legal systems

2. Providers of finance

3. Taxation

4. The Profession

5. Theory

6. Unnatural influences

As with the other attempts to classify and identify factors, the main criticism remains that such studies try to make simple a process which is extremely difficult to observe, let alone categorise and measure. As a consequence they can offer only a partial view: they seem to ignore the continuing interaction between accounting and its environment, the extent to which accounting may shape that environment, the possibility that the forces which shape accounting vary from issue to issue, the fact that accounting practice at any one moment represents an accumulation of the outcomes of many past debates, and the way in which accounting changes over time.

Taking Nobes' factors in turn, under legal systems he points to the common law tradition to be found in Britain and Ireland and the Roman law tradition to be found in France and Germany. He observes 'a common law rule seeks to provide an answer to a specific case rather than to formulate a general rule for the future' whereas Roman law seeks to formulate general rules, leading to a situation where 'company law or commercial codes need to make rules in detail for accounting and financial reporting'.

Nobes does not seek to expand on this, simply leaving the conclusion that in some countries accounting rules would be drawn up in detail and in other countries not. Presumably the implication of this is that one might expect to see greater variety of reporting in countries where rules were not detailed. But that seems an over-simplification: judgements about interpretation of individual situations will always bring variety in accounting on the one hand, while on the other the mere existence of a greater degree of freedom does not of itself guarantee that the freedom will be exercised – there are many other factors such as education and training which will constrain choices. It may be that Roman law environments offer obstacles to rapid change in a formal sense and encourage the development of secondary systems of reporting as happened not only in France but other countries (Archer & McLeay [forthcoming]).

In addition, not all authors are convinced that the common law/Roman law divide is so significant. Although many do cite differences in legal system as an important factor, a notable exception is Burggraaf [1983] who observes that 'in virtually all common law countries company law is based not on case law, but on legislation ... (while) the courts in civil law countries play no lesser role in developing case law than they do in common law countries'.

Providers of Finance replaces in the 1986 work Nobes' earlier categories of business type/ownership and the stock exchange which have been combined. In this category (as in the 1984 work) Nobes identifies a trend in continental Europe for much corporate finance to be provided by the banks rather than the stock exchanges, and for the public shareholder therefore to have a relatively lower priority than in the United Kingdom. He does not discuss the relative size or organization of companies and it will be argued later that in France particularly the size of companies and changes in this have been important in changing accounting requirements. Also the degree to which companies are involved in international trade has a significant impact – for example although companies may look to banks for finance, the origin of the bank itself may influence the way in which a company presents itself: a French company borrowing from a US bank may well wish to use US gaap measurements (interview Bellande [1986], Archer & McLeay [forthcoming]).

Nobes points out under 'taxation' that in most EC countries, including France, there is a tradition of using measurement rules worked out for tax assessment in published accounts, as opposed to the British tradition of separating external reporting from tax measurement. The implications of this are not particularly elaborated in the study although one could argue that it might lead to enhanced comparability of asset values within one jurisdiction since all companies were using the same depreciation schedule. It does not follow that where companies have freedom to determine their depreciation they actually exercise it, since again there are factors such as professional training and the influence of auditors which may also lead to uniformity. However, it is also true that if accelerated depreciation is available as a tax incentive to encourage investment this would lead to distortions.

In discussing the influence of the profession, Nobes grounds his argument in the relative strength of the profession in numerical terms between member states. He observes that 'the strength, size and competence of the accountancy profession in a country may follow to a large extent from the various factors outlined above and the type of financial reporting they have helped to produce'.In effect he seems to be saying that the nature of the profession can be used as a measure of the kind of accounting practised, and he observes that it also limits the future development in that (for example) where the Fourth Directive brings in an enlarged audit requirement some countries may not have the trained auditors to be able to enact this legislation.

However, this approach to the profession does not even mention the involvement of the profession in accounting regulation, the interests of the profession in expanding and maintaining its professional status, and the competing interests within the profession, all of which have roles to play in shaping accounting. At another level, Nobes' use of the size of individual professional bodies as measured by the number of members is a potentially misleading one. For example, in Britain there is an established tradition of regarding training and examination by a professional body as the normal route to an accounting career whether in industry or the profession. In France and other countries this is not necessarily the case – a diploma from a business school is a well-trodden route to accounting posts in industry, and in France those members of the professional body who move into industry automatically lose their membership of the professional body. Further, the role of the British accountant in tax and business consultancy is not replicated exactly in other European countries.

Under the heading of 'theory' Nobes cites Limperg as having heavily influenced accounting in the Netherlands in particular by encouraging the idea that accountants should be free to form a judgement about individual companies without the constraint of a detailed, formal set of accounting rules – greater importance was given to training in micro-economic theory. It can be seen from the classification studies reviewed above that the Netherlands usually provides classifiers with problems: Da Costa Bourgeois and Lawson [1978] declared it unclassifiable, while for Nair and Frank [1980] it was one of the few countries which regularly moved between groups depending upon the criteria chosen, which may support Nobes' contention about freedom of practice.

Finally under 'unnatural' influences Nobes groups together the effects of economic 'events' such as the collapse of the financial markets in the US, or changes brought about in the accounting of countries as a result of membership of the European Economic Community, or through colonisation. The description of these as 'unnatural' is perhaps clumsy and the examples quoted suggest that Nobes had in mind only major 'events'. However, this could be taken as a limited acknowledgement of ideas elaborated in Burchell, Clubb and Hopwood [1985] that accounting change takes place when a constellation of influences come together. This area of Nobes' analysis is the only one where he alludes to the dynamics of change, elsewhere he is simply categorising institutional aspects of each country.

Such an analysis has some use in drawing attention to differences between countries and mapping out the institutional lines which may serve in due course as the starting point for a deeper analysis of change. The approach used by Burchell, Clubb and Hopwood [1985] in relation to value added statements suggests that the influences which lead to change will not be the same, or will not have the same impact from one issue to another. Consequently it is necessary to look at particular examples of change and to attempt to make visible the influences which were at work in that case: one cannot specify in advance what factors will influence change.

The authors cited above have been seeking to identify factors which contribute to the creation of particular sets of accounting practices. But their approach is a very general one, identifying simply some major components of the business environment and typically not attempting to pursue further how these might interact with each other, or how each component may in fact consist of a number of interested groups with different objectives. Notably they also omit any overt mention of the influence of accounting professionals and their possible objectives, and (except in the case of the AAA) the influence of professional training, and any direct consideration of the State's interests in accounting.

Studies which aim to isolate a cohesive set of factors with which to distinguish between one accounting jurisdiction and another suffer from the problem that they start from a viewpoint which accepts that such a framework can be found, that there are relatively few factors which do influence accounting. But other researchers, for example Burchell et al [1980] or Hopwood [1985], take the view that accounting is intertwined with business and society generally in a far more subtle way. Consequently the sets of factors produced are likely to over-simplify and generalise, to the point where they are only relevant as a starting point from which to look further.

In the context of locating French and British practices, the determining factors identified suggest that in looking at the adoption of the true and fair view in France it will be necessary to consider (a) the impact of its use within a Roman law context when derived from a common law background; (b) the different providers of capital as between Britain and France; (c) the impact of taxation on accounting, but also any other State interventions in the context of economic planning; (d) the role of the profession.

Theories of Accounting Change

There is a body of accounting literature which seeks to explain how accounting practices are formed, how they change and what are the influences which shape them, but which is focussed upon change within one accounting jurisdiction, as compared with the body of literature which is explicitly international and comparative in its departure point. It is to these authors to whom one should turn next in order to deepen and amplify the area of enquiry for the transfer of the true and fair view.

Theory which sets out to explain or discuss what functions accounting serves and how it operates has only become a focus for accounting researchers relatively recently (Watts and Zimmerman [1986]) and has been characterised by a move from a situation where debate on accounting innovation was seen to take place, at least ostensibly, amongst those concerned to find the 'best' accounting to one where economic motivations are recognised (Zeff [1978] etc.) and by a growing exploration of accounting from a sociological perspective (Burchell et al [1980]). These two strands of enquiry into the factors which influence accounting and the operation of accounting are not unrelated, but it may be useful, at least initially, to review them separately.

Economic Consequences

Zeff [1972] had researched the standard-setting process in several countries and noted in relation to the United States that although the profession was formally involved with developing and promulgating accounting standards, this process had emerged during the 1930s in the wake of reforms of the capital markets. The Securities and Exchange Commission after considering the possibility of setting standards itself decided to leave to the profession the task of establishing principles for which there was 'substantial authoritative support' (Accounting Series Release no. 4). Zeff observed that the profession's activity in this area was sometimes heavily influenced by business (often through the agency of the Financial Executives Institute – FEI) and by government (sometimes by the SEC on its own account, sometimes through the tax regulators and the Administration in general).

As regards government intervention he cites accounting for investment tax credits as a case where the Administration thought that its economic policy, as expressed through fiscal incentives, would be frustrated by the financial reporting of it and therefore intervened to change the accounting.

He noted also that the FEI intervened sometimes by making representations directly to the profession and sometimes by making representations to the SEC. A few years later Zeff [1978] expressed the view that the involvement of the FEI in the standard-setting process (through its membership of the Financial Accounting Foundation) was an important development in the acceptance of standards. However, he noted also that the arguments used by business in debating standards had begun to change: business had ceased to refer to 'good' accounting and instead was discussing the economic consequences (such as reduction in the reported level of earnings) to corporations of proposed accounting changes.

Zeff's analysis suggests that development of accounting principles takes place in a political arena where those with economic and other interests seek to influence the outcomes of regulatory debates. The profession was anxious to secure for itself the right to specify what is generally accepted accounting, but that in specific instances the SEC might intervene in order to satisfy its own interests, or the government might do the same in support of economic or other issues or businesses might bring pressure to bear, either directly or indirectly through the SEC or government because they felt their economic well-being was threatened. Although Zeff's empirical studies did not include France, it is reasonable to suppose that the mechanisms he saw operating in the United States might be replicated elsewhere.

Further analysis of standard-setting in the United States was done by Watts and Zimmerman. In their 1978 paper they demonstrated that there was a correlation between lobbying by corporations in relation to proposed accounting standards and the likely impact on the earnings measurement of the corporation. Watts and Zimmerman's arguments are sited in the United States economy and depend in part upon management's compensation being directly related to earnings, either in terms of bonus or in terms of stock options whose market price responds to reported earnings. In an economy where management compensation was less directly geared to measured earnings, the benefit from lobbying would be less, but their research backs up Zeff's contention that management may have an interest in influencing individual accounting issues, an influence that is ignored in the comparative accounting literature discussed above.

In a later paper (Watts and Zimmerman [1979]) the authors advance the hypothesis that accounting prescriptions operate to reduce agency costs in the capital markets – they increase the reliance that investors put in managers by providing a monitoring process. The value of prescriptions (and audit) will vary from company to company: 'agency costs, in turn, are, among other things, a function of the amount of corporate debt outstanding and of the relative share of equity owned by the manager'. The assumption underlying the discussion is that of a background in the United States capital markets – i.e. an active public market in both stock and debt, and Watts and Zimmerman appear to assume that the monitoring which satisifies the equity market is the same as that for the debt market.

Going on from Watts and Zimmerman it would be reasonable to suggest that in an economy where the methods of financing corporate activity were different from those in the United States, the agency costs could take a different form and consequently the monitoring needs would be different. For example the bank manager lending to the shopkeeper next door does not need an audit report to confirm the existence of the business, nor if he has known the shopkeeper personally for 20 years will he automatically want certified profit and loss figures. However, in a situation of change in business financing patterns the agency costs and monitoring patterns would change. Businesses which wished to move into new capital markets would actively pursue accounting which would minimise their costs in seeking finance.

Zeff's analysis indicates that the process of accounting change is a political one and is likely to involve the profession, the capital markets, government and business, but different actors step forward in relation to different issues. Watts and Zimmerman suggest that corporate lobbying is related to potential economic effects of accounting principles and that accounting principles are an important component in the relationship between providers of finance and businesses, so that any change in structure and attitudes should lead to pressure for change in accounting.

Accounting and the social

The political nature of the accounting process is also pursued from the stance of understanding social interactions. The exploration of the intertwining of accounting with its social environment is at an early stage and many accountants still 'see accounting as having the potential for a basic technical neutrality, a potential which was seen as being protected by an overriding professional interest' (Hopwood [1985a]). Researchers concerned with accounting and the social, however, offer 'a more explicit view of the relationship which accounting has to social interests ... rejecting any technical or even professional neutrality. Accounting from this perspective did not merely facilitate the articulation of particular interests but it emerged from the active pursuit of interested endeavours' (Hopwood [1985a]). Thus, although approaching from a different theoretical base, there is a similar conclusion as to the political nature of the process from which accounting emerges.

In this context the idea of accounting change, or understanding how accounting changes, is inextricably bound up with trying to understand how accounting interacts with the environment in which it operates. Burchell et al [1980] provide a framework for analysing the interaction of accounting with society, noting that 'no longer seen as a mere assembly of calculative routines, it now functions as a cohesive and influential mechanism for economic and social management'.

The authors make the point that although accounting has a 'mission' identified by pronouncements such as the US conceptual framework, research suggests that its product is neither automatically useful to nor used by those to whom it is addressed – or at least for the purposes which its mission suggests. 'The roles which (financial accounting and reporting) serve are starting to be recognised as being shaped by the pressures which give rise to accounting innovation and change rather than any essence of the accounting mission'.

A further elaboration of the interaction of accounting with its environment is provided by Hopwood [1985b]: 'although accounting has important symbolic properties and is implicated in the management of changes in legitimacy in society at large ... it is more than a mere symbol. Accounting can penetrate into organisational functioning. It can create a particular visibility. It can facilitate the construction of a particular significance. It can shape the ways in which arguments can be mobilised and the information and bodies of expertise which are deemed relevant for their resolution. It can serve as a means of transferring power and influence, allowing what was hidden to be observed and enabling constraints to be imposed on economic action'.

Once accounting exists within enterprises, a number of groups or individuals have possibly competing interests in its functioning and development, both those who are affected by the visibilities it creates and those who are involved in its operation. Within the individual company, accounting measurement rules provide yardsticks by which performance is measured. As a result different groups have an economic interest in seeking a measurement which gives a better interpretation of their performance, or which makes visible their performance, perhaps at the expense of making invisible the performance of others. Equally those who provide measurements have a status which is linked to the usefulness of their measuring system – the more relied upon is their system, the more individual power they have. Consequently there may be groups who advance the utility of different measuring systems in order to enhance their own status.

External to the company it is conceivable that the visibility-giving nature of accounting provides a focus for an even wider range of interests. Managements typically wish to know as much as possible about competitors while preserving their own secrecy, the capital markets may wish for more visibility or visibility of a different nature. The state will probably in itself house a number of competing interests: as tax gatherer, as pursuer of a particular form of economic and social order, as exerciser of an accumulation of statutory obligations, many of which may be in oposition to each other. Any person or group who has any interest in corporate activity has a potential interest in the way in which corporate activity is made visible.

Equally those who are responsible for the visibility system, accounting, have an interest in preserving that particular method of making visible and in extending its function. The existence of professional bodies creates organised groups who have an interest in developing its functioning, not necessarily just as a response to technical demands but to enhance their standing, increase their power, or in response to manoeuvering by other professional organisations or the state etc. For example the creation of a standard-setting body in the United kingdom is seen (Zeff [1972]) as arising in part from public pressure for more uniformity in financial accounting, built up by newspapers, being met by a response first from one professional body then the others to protect their members' interests and forestall possible government intervention (which would have diminished the power of the professional institutions).

Once accounting is institutionalised the institutions take on a role of their own which is not necessarily related to accounting, but which will bear upon the way in which accounting is shaped. 'At best the roles of accounting and the practice of accounting would appear to have a rather equivocal relationship' (Burchell et al [1980]).

Given the many potentially interested parties, it would seem likely that any change would affect many groups, calling therefore either for considerable consensus as to the acceptability of the change, or for powerful forces behind the change to overcome opposition from those whose position might be (in their eyes) disadvantaged by the change.

Burchell et al [1980] take the the view that 'the conditions for accounting change are complex indeed. Whilst both technical and conceptual developments are required, to be influential they have to root themselves in a dynamic constellation of issues which constitutes the accounting context. In that constellation, both practice and the roles and functions which it serves and is seen as serving are subject to change as new issues emerge, new linkages to accounting (are) established and new needs for the standardization of accounting practice arise. With so many of these pressures emerging from institutions which at least claim a broader social significance, the roles which can be associated with accounting change can be different from those which subsequently might be implicated with its actual operation and use.'

Burchell, Clubb and Hopwood [1985] expand the idea of an 'accounting constellation' being a probable condition of change, in studying the rise and fall of the value-added statement in corporate reporting in the United Kingdom. They came to the conclusion that the statement came into being 'out of a complex interplay of institutions, issues and processes'.

In general terms they propose that change will emerge when a whole series of factors converge and produce change through their interaction. The factors will not necessarily be the same for every change and will frequently have no overt connection with accounting. 'We are concerned to emphasise the potential multitude of different actors acting on accounting in purposive ways in an array of different arenas, each having specific, often non-overlapping and sometimes conflicting interests in the accounting practice they are utilising and only partial knowledge of both its consequences and the resistance that its use will engender'.

Their analysis is genealogical, tracing in this case sequences of events in the 'arenas' of accounting standards, macro-economic management and industrial relations and information disclosure, and concentrating on the agencies of the government, the trade unions, the accounting profession etc. This approach is contrasted with the more traditional one of treating accounting as separate from its environment. Loft [1986], applying this approach to the emergence of cost accounting, says 'it is the examination of the history of accounting which provides a means to explore the complicated relationship between accounting and society'. The author cites Foucault and in particular his work on the development of prisons as providing a an example of the use of a genealogical perspective 'which provides a meticulously and patiently documented account of the social and historical conditions under which developed both these institutions and the techniques which they use'.

The links between accounting and the wider political environment are also examined by Lehman and Tinker [1987] who use an analysis of the subject matter of articles in two US accounting journals over a thirteen year period to demonstrate that the focuses of interest shifted over that period in a way which can be correlated with a shift in the nature of social and economic issues of the period as evidenced by editorial material in more general publications.

Hopwood [1987] uses three case studies of accounting change as a basis for better understanding how accounting change takes place. He notes that conventional discussions of accounting change see it in terms of technical improvement, and accepts that the power of abstract ideas to create change is valid – but observes that the way in which the abstract ideas themselves come to be developed or to be adopted is not of itself neutral, and is embedded in other changes. He says that accounting exercises a social power because it provides a means of making real particular conceptions of economic and social ends. Accounting as practiced measures particular activities in particular ways, and both the choice of way and the choice of activity act to focus attention on chosen aspects.

The three case studies deal with accounting and reporting functions internal to enterprises rather than external reports, but the points arising are relevant to external reporting. The first case reviews how the creation of cost accounting in Wedgwood's business created a reality or visibility which had not existed before; the second case showed how a company was obliged to change its accounting as part of a response to different market conditions while the third case involved a company whose management were so conditioned by their reporting system rather than the external reality that they failed initially to notice that economic conditions had changed. Each provides a study of 'accounting in motion' but Hopwood observes 'no unitary mobilising force ... embedded within the shifting course of accounting's subsequent path of modification'.

He also says there is 'an equivocal relationship between the aims in the name of which the craft is advanced and its actual organisational consequences ... moreover, a whole domain of the unanticipated can realise itself as accounting intersects with other organisational practices and processes, as it actively creates a new sphere of organisational visibility, objectivity and potential significance, and as, in the process of so doing, it engenders resistances to the strategies and interventions which it seeks to further'.

From the body of work cited, the view of accounting change is that one cannot pre-specify in any one case which agencies would be called into play, nor the roles which they would play, nor the outcomes of their interaction. In general terms the model for analysing change proposed in the arena of comparative international accounting, one where a small number of factors is specified and one should proceed to analyse the effects of each of these in relation to a change, is not supported. Instead accounting is proposed as the outcome of pressures, the origin of which cannot be predetermined. Accordingly, the research model suggested is one of reviewing the circumstances leading up to a change in accounting, from which one may attempt to identify actors in relation to that individual issue. Applied to the harmonisation process and the specific case of the adoption of the true and fair view in France, this implies that the analysis of the change should be based on a genealogical approach of examining the circumstances leading up to the change.

Interested parties

While the notion of specifying the determining factors causing change in advance of reviewing the change is rejected, on the grounds that the actors and their roles are likely to change from issue to issue, this does not mean that one rejects the idea that there are interested parties whose involvement in the visibilities of accounting is such that they are likely to have a role in many issues, in particular parties such as the state and the accounting profession.

In order to analyse and interpret the interactions which might have taken place in a particular instance, it is useful to have some model of the interests of these agencies in as far as they may have impact on accounting as a point of reference, while accepting that their role in relation to any individual issue may not coincide with the model.

The interests of the state may be complex, since the state is not an individual, rational force, but rather in itself a collection of different interests, reflecting inherited roles, responses to current problems and politically-motivated attempts to move in certain directions. The interaction between the state and the visibility created by accounting is the subject of a paper by Miller [1987] in which he examines some aspects of the relationship between accounting and the French state. Using the case study approach he examines the development of accounting in seventeenth century France under the influence of Colbert's aim to improve the operation of the Finance Ministry. The development of accounting was implicated in creating knowledge about economic events in order that the state could control or manage them.

In a way the Colbert case can be seen as similar to the Wedgwood case but transposed to a national rather than enterprise level. Miller says: 'defined in this way, accounting is a condition of emergence of the modern capitalist enterprise, and of the modern state; it also enables the latter to provide the conditions under which the former can operate'. The way in which it operates will not be the same in every country: 'decentralized states such as the US will be quite different from centralized states such as France'.

Miller [1986] reviews a work (Fourquet [1980]) which deals with the emergence of national accounting in France after the Second World War. He categorises the State's interest in accounting as being 'to document the wealth and power of the nation with a view to maximising it or distributing it in a different manner'. Fourquet examines the French government's adoption of central planning to achieve a rapid reconstruction and improvement of the post war economy, and the creation of a national accounting system as a means of making visible the economic activity which the state wished to control.

Miller observes: 'It is a history of a shift in what is viewed as both possible and legitimate as forms of intervention by the state in the economic and social life of the nation. This shift would not have taken the form that it did without the elaboration of the conceptual tools of national accounting.' But further, Fourquet's book 'demonstrates how the birth of a conceptual apparatus and its institutional form is a far from unproblematic process. It shows that new concepts do not emerge effortlessly in academic debate, that they are fully embedded in political and institutional rivalries'.

In the case of post war France, Fourquet shows that not all those concerned with government were in favour of economic planning, while those who were broadly in favour did not necessarily agree on the scope, objectives and nature of planning. Consequently the planning which emerged did so in a political arena as a compromise between competing groups. The accounting which emerged would also have been subject to the same pressures and would in itself have identified and limited, in its role as an enabling tool, the effects of planning.

The state has an interest in the visibilities created by accounting, of which the most obvious example is that of the measurement of profit for tax purposes. But this is not the state's only interest, and the general point can be seen from Fourquet that the State is not a single voice, rather it is a multiplicity of voices. Even within the same broad area (such as economic planning) there are competing interests who may be expected to intervene. Their intervention may be motivated indirectly, for example to prevent the acquisition of power by another group, and not be directly concerned with the overt debate at all.

The Accounting profession

By contrast with the State, a consumer of accountings, the interests of the accounting profession might be supposed to be, as a supplier of accountings, with the science of accounting in itself, rather than with the visibilities which it produces. Accountants provide visibilities, their interest at first sight might be the technical questions of how to measure in any individual case, and the client service question of what visibility is the client (internal or external to the enterprise) interested in. Such a view, though, leaves aside the question of the profession's interest in securing and improving its status. As Willmott [1986] observes: 'accountancy continues to be graced by a public image which, in stressing its technical, esoteric qualities, underplays the social and political formation of its practices and standards'.

Willmott argues that 'professional associations are primarily, but not exclusively, political bodies whose purpose is to define, organise, secure and advance the interests of their (most vocal and influential) members'(Italics in original). He sees the British accountancy profession as enjoying a 'privileged role as steward of the public interest' and the organised professional bodies as being unlikely to act except in defence against threatened government erosion of their status, or in the face of public concern about the nature of the profession's role, or as a result of internal pressures between different interest groups within the profession.

Professions have attracted the attention of sociologists, who have developed models which attempt to explain the phenomenon. Larson [1979] offers a view of a profession as a specialist body within the labour market who attempt to improve their status and reward in relation to the rest of the labour market. Johnson [1982] suggests that historically the development of professions is linked to the emergence of capitalism and the emergence of the bourgeoisie – 'it also entailed an attack on the operation of patronage in stressing occupationally-defined competence as the basis for individual entry and advancement within the profession'.

Larson sees 'the professionalisation project' as seeking to take control of the supply of the product and control of the demand for it, in other words to control the market. On the supply side, this may consist of controlling entry to the profession and controlling the cognitive base as far as possible. On the demand side this may consist of controlling demand, frequently through State endorsement of the profession's unique right to provide a particular service.

Child and Fulk [1982] say that 'a monopoly of access to knowledge intrinsic to the performance of tasks is the fundamental basis for occupational control over the conduct of work'. They also draw attention to the possibility that the profession is diverted and fragmented by the segmented nature of professional employment. Thus there are horizontal differences between those working in audit firms, and those working for non-accounting employers; within the latter group between profit-distributing enterprises, public sector bodies and academe. There are hierarchical differences between otherwise similarly qualified professionals within individual accounting firms, differences arising from the different size and importance of the employing firm (international practice/national practice/local practice) and so on. The interests of all professionally qualified accountants are not homogeneous.

The authors also analyse 'power and authority in client-professional relations' which they see as having an important impact on control of the profession. They note that accounting, architecture and engineering benefit from having mainly corporate or governmental clients and therefore less impact on personal welfare than professionals such as doctors. However, they also note that in the United States malpractice suits against accountants became commonplace in the 1970s.

The relations between a profession and the state are frequently seen as extremely complicated. Child and Fulk see the state through manifold agencies interacting with professions by '(1) interventions over standards of work; (2) interventions over market place controls; (3) public employment of professionals; and (4) effects on the supply of new recruits to the professional labor market through the public funding of training programmes'.

Johnson [1982] notes that there is a conventional view that there is an opposition between state intervention and professional autonomy. He rejects this and offers the hypothesis that the development of a profession exists alongside the development of the state and interacts with it, each helping to define and extend each other's role. He cites Britain's dependence on professional bodies to help with the administration of the colonies by supplying and training professionals as a contributory factor in the growth of power for the accounting bodies. The state benefited in its mission and gave recognition within Britain for the services provided. Larson [1979] cites state endorsement as a major means of market control for professions, and notes that statutory requirements for audit provide a captive market for the accounting profession.

In considering, then, the impact of a change in accounting, it would be relevant to review the way in which that change might operate or might be perceived to operate in relation to the specific interests identified. Evidently a change in accounting regulation would change the cognitive base of the profession, which might improve professional control, diminish it, or not have any significant bearing. A change which opened up entry to the profession or devalued the cognitive base would though be likely to meet resistance.

Different groups within the accounting profession may be seen to have different interests, and consequently their reactions would differ, and it is also possible that some might use the possibility of change in an attempt to improve their own standing within the profession.

Accountants would have to consider the possible effects of change upon their clients, with again differing reactions depending upon the nature and needs of their clients. Finally the way in which the change impinged upon relations with the state would also be crucial. The change might involve the state conferring additional privilege on the profession, or reducing privilege. The state might in any event use this threat as a means of encouraging change which it saw as supporting its own interests.

The capital markets

It is generally assumed by accounting regulators that the major consumer of accountings is the capital market. For example in the US the first statement in the conceptual framework identifies the purpose of financial statements as being to provide decision-useful information to the investor/creditor group. While not accepting that regulations are drawn up with the investor/creditor group in mind, it may be useful, in the context of identifying agents with an interest in influencing accounting change, to review the possible implications of change for actors in the capital markets. If investors or their agents use accounting information, then they may be presumed to be affected by change and have some interest in trying to influence change.

The Efficient Markets Hypothesis suggests that, in its semi-strong form, the best long-term policy for investors is to buy and hold the market (for example Beaver [1981], Keane [1983]), only those with access to inside information are able to make abnormal returns. The corollary from this is that the more information is available to the market, the more accurate is the price of the security, and the smaller the opportunities for insider-dealing.

In a study of the methods used by investment analysts to appraise share investments, Arnold and Moizer [1984] bring forward evidence to show that majority practice amongst analysts, despite the Efficient Markets evidence, is to make their own prediction of share prices in an attempt to identify shares which are under-priced by the market. This is done by using fundamental analysis to produce a forecast of earnings for a company, then deriving an appropriate price/earnings ratio to produce a forecast price. Support for this as the main basis for analysis is also provided by Belkaoui, Kahl and Peyrard [1977]. The earnings number measured by accounting would therefore seem to be important in investment analysis.

Arnold and Moizer conducted a questionnaire survey amongst analysts in order to obtain evidence of the techniques used which provides more detailed empirical evidence of the importance of accounting numbers to analysts. This revealed that the annual profit and loss account and balance sheet of the company were ranked as the two most important sources of information to the analyst, with quarterly and six-monthly results as the third most important source and company personnel as the fourth. There is some possibility that analysts would not wish to reveal their informal sources and that the 'official' sources are over-stressed, but the authors noted: 'many analysts wrote comments on this section, which was clearly the most contentious part of the questionnaire. In spite of the perceived influence of information provided by management, some of the analysts appear to be fairly sceptical about management opinions'.

The Efficient Markets Hypothesis suggests in its semi-strong form that more information helps make the market nearer perfect and reduces the opportunity for insider dealing. Arnold and Moizer's study suggests that little faith is put in the Efficient Markets Hypothesis by professional share analysts, but that such analysts place some importance on the published accounting reports of companies. From both perspectives, therefore, one might expect that agents in the capital markets would have some interest in improving the quality of corporate accounting disclosures.

That this interest is not uniform, nor unambiguous, is discussed in Beaver [1981] and demonstrated in a further paper by Moizer and Arnold [1984]. Beaver observes that the information intermediary's attitude to disclosure is ambivalent in that general disclosure by the firm diminishes the investor's demand for the intermediary's product, but on the other hand firm disclosures are a factor of production for the intermediary.

Moizer and Arnold point out that some investment analysts use their analysis in the context of managing a portfolio, whereas others are information intermediaries such as stockbrokers whose appraisals are used by third parties. The paper presents a model of the different motivations of the two groups based on agency theory put forward by Jensen and Meckling [1976]. Information intermediaries have a role to play in assisting the monitoring of the agent by the principal: they provide comparative analysis of management performance etc. Intermediaries may find it useful to incur bonding costs to encourage the trust of principals, which would lead them to carry out more rigorous and regular analysis. At the same time, information intermediaries in this context often earn their reward through investors buying and selling shares, therefore they have an incentive to encourage such activity.

The analyst who is a fund manager has two roles: the manager is an agent of the principals who invest in the fund, but also represents the principal in the role with the management of individual companies. The fund manager's performance is likely to be judged by the performance of the fund as a whole. Moizer and Arnold take the view that 'there would appear to be no additional personal return to the portfolio manager for undertaking more than the analysis he would need to build portfolios with the risk and return characteristics regarded as satisfactory by his clients'.

The authors carried out an analysis of their questionnaire results to test for differences of attitude by the two sets of analysts. This showed that 'investment analysts who are information intermediaries undertake analyses which are both more detailed and more frequent than those undertaken by their portfolio manager colleagues'. A practical effect of divergent attitudes was noticed in respect of a question as to whether companies should be asked to provide a forecast of the next year's sales and profits in the annual report. Portfolio managers were in favour while information intermediaries were against, and the authors suggest this may be because the value of the intermediaries' monitoring is reduced if the management undertake part of it. Viewed from another perspective, that of the providers of visibilities, stock-brokers could be seen to have a professional interest in preserving their right to add to the accounting visibility or modify it which potentially conflicts with the professional interest of accountants as suppliers of visibilities.

Both theory and empirical evidence suggest that accounting reports are potentially important to the capital markets, even though different actors will have different needs and different attitudes. In terms of a study of accounting change one might then expect that investors would be affected by change and would have some motivation to attempt to influence accounting regulation, although different actors within the investment community could be expected to have different reactions.

If accounting numbers are important in determining the capital market's perception of a company's performance, then it must follow that company management have a strong interest in influencing accounting measurements. The Jensen and Meckling [1976] agency theory has been applied in this context by Watts and Zimmerman [1978], [1979] as discussed above. The general argument advanced is that principals need to monitor the activities of their agents and accounting regulation has an important role to play in harmonising monitoring and reducing monitoring costs. Principals are likely to encourage monitoring, while agents are likely to attempt to influence the monitoring process to provide the most favourable view of their activities.

In looking at the possible motivations of various interest groups in relation to changes in accounting regulation, the object of the exercise has been to establish a series of models which may serve as reference points in analysing the changes which took place in relation to the adoption of the true and fair view in France. However, these models are not in themselves intended to serve as a starting point. Rather it is intended to use the genealogical approach suggested by Burchell, Clubb and Hopwood [1985] and Loft [1986]. The intention is to examine the process of change with no over-riding prior assumptions about either the role of accounting or the roles of those concerned with this particular example of change. The motivational models discussed above are intended to serve as analytical tools in the interpretation of the events which took place, rather than the events being analysed to consider whether or not they support the motivational model.

However, these motivational models are, of course, an important element in reviewing the process of harmonisation. If there are competing interest groups within an economy who wish to influence the outcomes of accounting reglation, and these groups have diverse motivations, then the interplay of these groups is likely to have differing effects on regulation in different economies, which might be expected to frustrate, or at least limit, attempts to reduce accounting differences.

So far in this chapter the subject of harmonisation as such has not been addressed directly: the focus has been to identify accounting differences, to identify the reasons for those differences and to locate France and Britain in that context. Classification studies have been reviewed and the accompanying literature which attempts to isolate environmental factors which might explain national differences, such as dependence on one or other system of law, nature of national capital markets etc., has been examined. This has been contrasted with theories of accounting change which suggest that national gaap are a collection of practices which have evolved in a relatively arbitrary manner through the interplay of interested parties on an issue by issue basis.

This analysis provides some insights into the existence of accounting differences and the probability that difficulties will be encountered in reducing them, as a result of their diverse origins. The next step is to consider the literature which is concerned with harmonisation as such, before going on to suggest an analytical model for the review of the French use of the British true and fair view.

Harmonisation of Accounting

The process of harmonisation in the European context offers those who would wish to influence accounting a new forum within which to operate: the efforts of those who would wish to defend or advance particular interests within a national jurisdiction are faced with the possibility of legally-enforceable change being agreed outside that jurisdiction. At the same time, new interests are likely to be aroused.

The economic consequences of new accounting regulation at Community level are self-evidently much greater than at national level. Within the regulation-forming process representatives of individual countries may wish to secure the least possible change for their constituents in order to minimise the cost, or may suffer from nationalistic tendencies. The possible effects of the process are such that groups whose interests are relatively remote take formal lobbying action at a Community level where it might not be considered worthwhile at a national level (e.g. US Chamber of Commerce lobbying on behalf of US commercial interests at Brussels).

The formal justification for accounting harmonisation within the European Community is usually cited as being the furtherance of the fundamental principle of the Market that there should be freedom of establishment throughout the Community for business enterprises, from which the Commission takes the view that there should be relative uniformity of Company Law (van Hulle [1986]).

In practical terms this translated into a desire on the part of the European Commission to avoid two problems (Coleman and Petite [1983]), firstly to avoid having, in different member states, 'widely differing, or worse, contradictory reporting and disclosure requirements' and secondly, to avoid competition between member states to act as a base for companies. It was observed that, if establishment throughout the Community became easier there would be greater incentives for companies to locate themselves in the most congenial fiscal and legal environment, and indeed member states might compete to provide attractive locations, as was the experience of the United States.

An advantage of harmonisation, not necessarily within a Community context, which is cited by those in favour of it, is the possible improvement to the functioning of the international capital markets. For example, Lord Benson, the founding chairman of the International Accounting Standards Committee said [1981] 'We trade across national frontiers and the exchange of goods and services is international. If a multinational company is listed on the bourses of the free world or is raising money on world markets, there should be some yardstick, known to the public, by which its operations can be judged'.

Choi and Bavishi [1983] say: 'in addition to problems of comparability, message distortions caused by accounting measurement and reporting differences could lead to poor investment decisions, reducing capital market efficiency and ultimately, societal welfare'.

Although these advantages are cited for international harmonization it is not certain that they would automatically accrue to harmonization restricted to the sub-set which the European Community forms of the developed world. Nonetheless, Coleman [1984] claims them for EC harmonization: 'From the early days of the company law programme the European Federation of Associations of Financial Analysts has ... supported the Commission's proposals as a necessary and appropriate solution to the problems experienced daily by companies' shareholders, clients, suppliers, bankers (actual and, more important from the point of view of development of the Community, potential).' and 'from the perspective of the enterprises themselves ... divergent reporting and accounting requirements create obvious difficulties'.

In the context of research into the Efficient Markets Hypothesis there is some research evidence that the market is not fooled by manipulations of accounting numbers and this might lead to a view that harmonisation was unnecessary. However, there is also the argument discussed above that in its semi-strong form the market allows abnormal returns to insider-dealing and that this implies that more disclosure would reduce the return to insider-dealing.

There is evidence that analysts place importance upon published financial statements and wish to have information which will enable them to make good earnings forecasts. It may be then that, despite theoretical doubts about the usefulness of accounts to the markets, because analysts perceive accounts to be useful they will be encouraged to deal in securities whose accounts are expressed in a form readily understood by the analysts.

Whatever the benefits proposed, the potential range of interest groups affected by harmonisation of accounting is considerable. Burggraaff [1983] discussed interest groups in terms of users and preparers:The users are 'a mixture of allies, enemies and competitors', while for the preparers 'information is a tool for management to influence the behaviour of its environment'.

He points out that governmental involvement in harmonization is also inevitable: 'interest groups may turn to government for help in their struggle to get all the information they want. If the demanding group is influential, politicians have a tendency to listen to those demands' and also 'enterprises, and especially the larger ones, are of major importance to the national economy'. He comments: 'in today's society information means power. No government can afford to leave that power outside its control and no government in Europe has abstained from legislating in respect to company reporting. It would be unrealistic to expect otherwise.'

He suggests agreement on underlying concepts may help the harmonization process but notes: 'this issue is highly controversial in Europe and has strong ideological overtones since the fundamental question is: for whose benefit is an enterprise allowed to operate ? The struggle in the political arena will decide which view prevails and a shift in the balance of political power may cause a shift in objectives accorded to business enterprise'. He suggests that 'there should be some sort of consensus and more often than not that leads to a compromise. Nobody is quite satisfied, but most parties are prepared to settle for it just now and to wait for their next opportunity'.

Accountants are inevitably a major interest group in the harmonisation arena, although their interests are several and differ between different sections. Bedford [1966] claims that international activity enhances the professional status of accountants by enhancing the cognitive base: 'an essential characteristic of all professions seems to be the striving to be international ... accountancy will have to constantly expand its technology in order to retain its distinctive professional status'.

Scheid and Standish [forthcoming] see other motivations: 'there are large prizes to be won in terms of international accounting practice, access to international clients, and commercialisation of computer software and financial information products'. They say 'it is hard not to conclude that harmonisation occurs as and when non-English speaking countries give up whatever indigenous accounting practices they may have developed in favour of Anglo-American accounting standards. In other words, harmonisation over the last few decades may be likened to early conversions of the heathen to Christianity or of the infidel to Islam'.

Given the political nature of the harmonisation process, a critical concern in reaching a workable result is how far the process is intended to lead to uniformity. Evidently the smaller the freedom to deviate from the norm, the more difficult is likely to be the process of reaching agreement between the interested parties. On the other hand, the greater the freedom to deviate, the less likely it is that the resulting accountings will be comparable. The debate within the harmonisation arena can therefore be made easier by relaxing the harmonisation constraint: compromise between groups can be achieved by negotiating not only the individual accounting issue but also the degree of uniformity.

Coleman and Petite say that 'laws and codes in the field of disclosure, accounting and auditing have a framework character. They do not normally seek to regulate every detail of an enterprise's public reporting'. They emphasise that the framework character is essential given the 'limited number of issues that can be mutually agreed as being worthwhile within a reasonable period' and also 'derives in part from the political nature of the rule-making process which also determines to a great extent the content of the rules themselves'.

An important aspect of this is the question of whether harmonization should stop at disclosure or include measurement: Choi and Bavishi [1983] question 'the wisdom of attempting to harmonize corporate disclosure when many of the amounts disclosed are still arrived at by the use of different accounting principles'. Nobes [1980] says: 'harmonization of accounting is a process whereby the size and number of differences in practice between countries are reduced. It does not imply complete standardization that would require uniform and rigid rules throughout the EEC'.

Obstacles to harmonisation

The differences to be arranged by the harmonisation process involve not only compromise between different interest groups, but also cultural approaches which underlie attitudes to accounting and company law. Several authors see these differences as being so severe as to make EC harmonisation impossible to achieve.

An outright rejection of the possibility of harmonization is made by Busse von Colbe [1983]. He identifies five barriers to harmonization:

1. Absence of agreement on optimal reporting practice: 'different weights are given to the various goals of accounting in the different countries joined together in the harmonization efforts'. Since there is no agreed objective for corporate reporting, it is impossible to decide in what direction harmonization should move.

2. Different goals demand different methods of accounting: for example in Germany 'protection of creditors (against bankruptcy) has first priority' leading to undervaluation of assets, where in other countries the emphasis is on shareholder reporting.

3. The degree of agreement within the EEC on fundamental questions is low: for example attitudes to inflation accounting are widely divergent.

4. The cost of providing information is ignored.

5. Accounting is part of the national socio-economic system: 'the economic consequences of an accounting rule faced by a firm can be completely different from country to country'. He notes by way of example that the dividend payable to shareholders of a German company may be regulated by law as a percentage of measured profit, so any change in measurement rules will automatically change the dividend payable on the same underlying transactions.

Even Coleman and Petite [1983] accept an obstacle to EC harmonization is that rules already existed in member states and 'moreover these rules have frequently developed over relatively long periods of time, are themselves the expression of a political process, and are closely linked with structures, procedures, institutions and modes of thought that are deeply rooted and not necessarily susceptible to rapid change'.

McComb [1979] recognizes 'two factors which operate as constraints upon the processes of the international harmonization of accounting theory and practice can be identified:

1. Variations in perception of the objectives of corporate business organisations; and

2. Differences in what are regarded as the ranking of the objectives of accounting for corporate business organizations'.

He takes the view that 'international harmonization of accounting will not come about as the result of the imposition of uniform accounting practices' because this does not address the (to him) fundamental issues of corporate objectives which 'have a major qualitative influence on the information content of accounts'.

Gray [1980] is also sceptical: 'it would seem that success will require careful consideration of the differential influence of the various user groups interested in company accounts in each of the countries concerned. A uniformity of general accounting principles, especially the fundamental conservatism or prudence principle, can only give a false sense of progress when what is significant is the way in which such a principle is applied. Until there is a more rigourous and common approach to the treatment of items such as provisions, reserves, extraordinary and exceptional gains and losses, stock valuation, and depreciation, harmonization will be an illusion. Indeed the EEC's Fourth Directive is in danger of becoming just such an example of harmonization at the superficial level'.

Burggraaff [1983] also refers to the competing traditions within Europe as between the continental tradition of conservative valuations with a creditor perspective and what he calls the Atlantic fringe countries' shareholder perspective. He says 'in order to get the Fourth Directive out, the EEC had to accommodate both views'. He also comments that 'some member states did not use the Fourth Directive as a point of departure for a new law, but instead took existing national law, adapting that law where necessary to the requirements of the Directive. It is disappointing to note that we shall continue to have national legislations that will be as difficult to compare with one another as they were before'.

There seems to be an implicit assumption in the harmonization literature that there can be only one accounting for an enterprise, and without that assumption there is no debatecompanies could prepare reports for as many constitutencies as they thought appropriate. There is an existing tradition of European companies preparing different reports for different markets (e.g Archer amd McCleay, forthcoming) and the past evidence (Choi [1973]) is that use of the European capital market increases voluntary disclosure by European enterprises.

Multiple base reporting is discussed by some writers as a possible alternative to harmonization, but Burggraaff [1983] articulates the profession's opposition to this: 'the ordinary reader is at a loss to determine what figure is relevant to him and his confidence in the ability of the profession to prepare relevant and reliable figures will be eroded'.

However, if it is thought essential that there be only one, multi-purpose report, then clearly the specification of that accounting will be a focus for many interest groups. The process of formulating the harmonised rules will take place in a political arena where the international politics of the EC will provide an added dimension to the politics of accounting change.

It would seem inevitable that the regulations which would emerge from such a process would have more to do with the realities of the political process than any formal objective or any perception of the effects of the regulation. Such harmonisation would be met at the implementation stage with conflicting cultural standpoints about the nature and purpose both of the enterprise and accounting reports and would probably be superimposed onto existing legislation at a member state level rather than providing a new starting point.

It would be likely that accounting harmonisation directives would in themselves consist of a disparate collection of accounting requirements arising out of a series of political trade-offs on a point by point basis, and include optional elements in various areas which gave such latitude as to allow different states to follow substantially different methods. In implementation, member states could subtly alter the emphasis and interpretation of the directives to fit more comfortably with the existing local customs and practices.

Conclusion

The object of this chapter is to consider the classification and reduction of accounting differences and locate British and French accounting practice in order to establish an analytical framework against which to evaluate the adoption by France of the true and fair view in the context of harmonisation of corporate reporting within the European Community. (Consideration of the true and fair view itself is deferred until the next chapter).

The literature which specifically addresses comparative international accounting and attempts to classify national practices generally locates British and French practices in different groups. However, the classification studies are far from unanimous in their conclusions which suggests that although differences are clearly discernible they do not occur in a such a systematic fashion as to permit of any but the most general classification.

The classification literature also attempts to observe factors which determine the character of national practices. However, this too is found to be restricted to observing environmental factors of a rather general nature without any attempt to account for the evolution of practice over time. This literature is found to be open to the charge of being too simplistic and incapable of providing insights into differences and therefore shed light on question of harmonisation other than at the most general level.

A major problem in this literature is that there appears to be an assumption underlying the approach that (i) the body of accounting practices within one jurisdiction will be a rational, coherent and internally consistent collection, and (ii) the nature of these practices will be determined by institutional factors which are constant. The process of classification demands that a relatively small number of determining factors can be identified and used to group countries, the classifier must presumably believe therefore that these conditions hold true.

However, even in countries where codes of accounts operate, the mass of generally accepted accounting principles are built up over time and represent potentially the sum of a series of pragmatic outcomes of debate over a long period of time. It would be surprising under such circumstances if generally accepted accounting principles in any jurisdiction could be regarded as internally consistent. The difficulties encountered by accountants seeking a conceptual framework for accounting (e.g Macve [1981]) provides prima facie evidence of lack of consistency.

Understanding of the factors which influence accounting regulation has advanced to the point where different forces are seen to be brought in to play by different accounting issues, and the whole process of regulation is seen to be a political one. In such an environment the interest groups may not be concerned by the accounting outcome at all, but rather at its implications for their role or status – the accounting outcomes can be almost an accidental by-product. Consequently, any attempt to observe and categorise the formative factors by reference to the accounting outcome presumes a cause and effect relationship which is rather doubtful.

On the basis that neither the body of accounting practices within a country nor the factors which have shaped them are consistent or static, the classification process is likely to throw up general environmental factors only since they are (relatively) consistent in their presence. These are not without interest, but are perhaps the scenery before which the actors play out their roles, rather than actors themselves.

It is therefore to the literature which deals with accounting changes and the process of change which supplies a model for analysing the change in French accounting manifested by the adoption of the true and fair view. Burchell, Clubb and Hopwood [1985] and Loft [1986] suggest that while there are evidently some interest groups (e.g. the profession, the state) with continuing roles in accounting, on any particular issue a number of interest groups will be concerned, often including competing interest groups within the same umbrella such as the profession. Accounting makes visible or leaves invisible and the choice of accounting methods will direct attention in particular ways or serve particular interests.

The nature of the influence exerted by these interests will vary from issue to issue, and a change in accounting will emerge from a constellation of influences which converge at a particular time. From this perspective it is impossible to predict what influences will concern themselves and in what way with future issues. The study of change can only usefully take place from a historical, a genealogical, perspective. The researcher must sift the evidence of the events which took place to determine what was the process on a particular issue, and this is the approach which will be used to analyse the adoption of the true and fair view in France.

Although a genealogical approach requires that one proceeds from the events to the influences, it is useful to establish an analytical basis for potential major influences which may provide insights when interpreting the events which are observed. The accounting profession is seen as a having a role to advance and protect the standing of its members. This is seen as preserving as far as possible both control of entry into the profession and demand for the profession's services. The preservation of an esoteric cognitive base is seen as important to these aims. The profession is seen, notwithstanding, as having within itself different interest groups with different objectives, so that wherever the profession has to put forward a unified stance in the process of a debate, this stance will itself probably have emerged from a related debate within the profession.

The profession is seen as having an ambivalent role in relation to the various organs of the state. Since the state is important in protecting the profession's monopoly, the profession has motives both to co-operate with the state and to prevent its interference in activities which bear upon the profession's standing.

The state itself is seen as consisting of numerous sub-entities, each with their own motives and their own internal political processes. The state acts as tax gatherer but also as supporter of economic development. Different elements have different information needs and different opportunities to influence the provision of information. Different groups may be served by different visibilities.

The provision of accounting information is important for the capital markets, with implications for the pricing of securities. This creates a situation where the market may, in general, wish to influence corporate reporting. At the same time managers have interests both in encouraging monitoring through accounting reports, but in influencing the way in which reports are prepared in order to show a favourable picture of the company.

In the context of this study these actors may potentially have roles to play in two debates. There is the harmonisation debate at European Community level and the implementation debate within France. The preparation of the accounting directives, and specifically the Fourth Directive, provide an opportunity for different groups to influence regulation. This is an overtly political process and has the possibility of arousing nationalistic as well as economic and party political considerations.

The likely outcome of such debate is a patchwork of compromises, including provisions which left areas which are either open to wide interpretation or deliberately leave choices open to the member states. The nature of harmonisation makes it also likely that it would address disclosure rather than measurement, and would not address other basic issues such as the role of business entities or the role of corporate reporting.

At the implementation level it is likely that interest groups would try to influence implementation to best satisfy their own needs, and that therefore implementation in one state would be different from that in another. It is also likely that EC-inspired legislation would be grafted on to existing national legislative frameworks, leading to further compromise. It might therefore be expected that a flexible concept such as the true and fair view would not emerge unchanged by the process. In its adoption by France it would have gone through the European Community arena and then through debate at a national level in France.

CHAPTER III

The True and Fair View in Britain

This study sets out to provide an analysis of the adoption of the true and fair view in French accounting as an instance of harmonisation of accounting. Having discussed in the previous chapter the literature which attempts to classify and explain different national practices and that which treats the possibility of reducing differences, as well as that which considers the forces which influence accounting change, the next steps are to examine the true and fair view in its original British context in this chapter, then in subsequent chapters in the context of its adoption by the European Commission within the Fourth Directive and finally in its adaptation within French accounting law.

British company law requires that the balance sheet and profit and loss account give a true and fair view of the state of affairs of a company and of its profit or loss (Companies Act 1985 s.228 (2)). The scope of accounting standards is defined by the Accounting Standards Committee as 'applicable to all financial statements whose purpose is to give a true and fair view' and the foreword to accounting standards refers to 'the overriding aim of giving a true and fair view'. Apparently the term occupies a central position in external financial accounting for commercial companies.

In this British environment the true and fair view as the expression used in company law to describe the over-riding objective to be met in preparing external enterprise accounts, is the successor to a line of such phrases used by parliament since the inception of limited liability companies. It is, however, notoriously indeterminate in character and therefore flexible in interpretation. It may be that its very flexibility makes it suitable for transfer across national and cultural boundaries, for example it has been transferred into the legislation of Commonwealth countries at different times.

Given that the notion is central to financial accounting, it might be a rational expectation that it would be well defined by those whose function it is to operationalise it. However this is not so, and the very flexibility of the notion prompts some consideration as to whether those who have an interest in influencing accounting regulation might also have an interest in preserving this flexibility. The possibility will be advanced that an indeterminate notion is helpful to regulators in the sense that a tightly-defined notion would reduce the area open to discussion and therefore reduce the possibility of influencing the outcomes of debate, and also that in the context of the advancement of a profession the preservation of an arcane cognitive base may benefit the standing of a profession.

In this chapter the historical origins of true and fair will be examined, the interpretations in the current literature analysed and finally some of the implications of its indeterminate nature will be considered.

True and Fair as a Sign

In considering the history of true and fair, it may be useful to separate the legal formula from the concepts or ideas underlying that formula. This in turn will allow some consideration of the relationship between the concepts and the way in which they are actualised. The relationship between the formula used and the underlying idea is not necessarily straight forward. It is not for example clear that a change in the formula such as that from true and correct to true and fair in 1947, involved a simultaneous change in the underlying idea.

Semiotics, the science of signs, provides some analysis of this relationship. Saussure [1917] advanced the theory that words or phrases used as signs in communication may be split into a signifier, the collection of letters which form the word or phrase, and a signified the underlying object or idea conveyed by the sign. Particular culture groups are identified by a common use of the same signifiers and signified. The signifier 'dog' conveys a barking, domestic quadruped signified in an English-speaking culture. The same signified in a French culture is conveyed by the signifier 'chien', while the 'dog' signifier in a French slang context could convey an academic diploma signified.

This approach can be applied to accounting to distinguish the true and fair signifier from the signified. In the 1985 Companies Act the overall objective of the annual accounts is said to be to give a true and fair view of the company's state of affairs. The signifier 'true and fair view' (the phrase) relates to a signified (an underlying idea) which is some notion of an annual accounting report. In following the history of true and fair, the legal formula or signifier can be traced as it appears in a succession of companies acts, but these will not necessarily relate to change in the signified.

Semiotics observes that it is in the nature of signs that both signifier and signified will change over time as the circumstances of the particular culture group in which they are used change (Culler [1982]). An example of this might be the use of the 'transistor' signifier, whose signified originally was an electrical component but which developed, in popular speech at least, a secondary signified as a domestic radio receiver following on from its widespread adoption in the early 1960s as a component for such appliances.

The signified generally carries with it a series of subsidiary connotations (Barthes [1973]) which expand the image conveyed. For example the signified of 'street' will differ slightly from one person to another but in all cases probably involves visualising a street complete with pavements, street lamps, traffic etc. The signified carries with it connotations which are built up from the use of the term within the culture group. This suggests that where the signified is an abstract idea, such as a cricket match, anyone using the sign 'cricket match' thinks of an actual cricket match, and any expression of such an idea is not independent of the context within which it operates.

A local match on the village green conveys a different image from an international test match, a village cricket match in 1840 (say) would be somewhat different from such a match in 1988. If the signified is not independent of the actualisation of what is signified, then the meaning conveyed will be changed as the way in which the idea is actualised changes. So the cricket signified is capable of being altered subtly by changes in the rules of the game or the way in which the game is played, for example the introduction of 'body line' bowling as a technique meant that the spectacle offered was changed by a different kind of bowling and a different batting technique evolved to cope with the bowling.

The relation between an idea and its actualisation is not clear. For example it is often not clear whether a change in actualisation is brought in following a change in the accepted notion or whether the change in actualisation in itself changes the notion. In the cricket case, did bodyline bowling come in because the generally accepted concept of a cricket match had altered subtly, or did the use of bodyline bowling create a change in the notion. In either event the signified denoted by the cricket match signifier would be marginally different after the introduction of the technique. Such subtle changes take place successively over time and are sometimes hard to discern except retrospectively when it is apparent that a series of incremental changes, each minor in itself, have perceptibly modified the signified.

From the viewpoint of semiotics. the true and fair signified cannot usefully be separated from its context and from the way in which it is actualised. Detailed changes in accepted accounting practice can lead to changes in what are offered as true and fair accounts, and thereby alter the signified. Changes also will occur as the culture group which uses true and fair, primarily accountants, shifts its ground on related areas such as whether accounts are intended purely for shareholders or should serve other purposes, and what information is relevant for shareholders. Such changes take place slowly and one can only point to celebrated moments as markers which indicate that a change has taken place.

One example of the shift in the true and fair signified is the adoption of consolidated accounts. Garnsey's lecture on the merits of consolidated accounts took place in 1921 and was publicised in 1922, and is the first example of an attempt to persuade the profession to adopt the technique. The first accounts to be published using this method appeared in the 1930s and the technique became incorporated in company law in the 1947 Companies Act. The true and fair signified had been modified to include this technique over a 25 year period, the technique itself involves giving more sophisticated information to the shareholder and its acceptance implies a modification in the concepts of what purpose the accounts serve.

This two-way relationship whereby a change in concepts can cause new techniques to be adopted but also the adoption of a technique implicitly changes the underlying concepts provides the rationale in subsequent chapters for examining not only what French accountants think true and fair means, but what accounts are produced as being true and fair.

Historical Origins

In analysing the British origins of true and fair, it is useful to distinguish between the development of the signifier (the legal formula) and that of the signified (what the nature of annual accounts should be). The signifier is encoded in British company law and changes are therefore easy to observe, whereas what people who use the term mean by it is likely to change over time, but to do so in such a gradual way that it is rather more difficult to chart its movement. The signifier is a comparatively static element whereas the signified is dynamic.

The true and fair signifier came into existence in law in 1947 (and was then consolidated into the 1948 Companies Act) following on the recommendations of the Cohen Commission. It was, though, simply the most recent version of a line of similar signifiers which first appeared in company law in 1844 when company law first began to be formulated. The Joint Stock Companies Act of 1844 required that companies should produce a 'full and fair' balance sheet, even though as Chastney [1975] remarks "there was no collection of precepts to give unequivocal meaning to the phrase". The Act did not specify what should be shown in the balance sheet, nor did it ask for a profit and loss account.

There was a piece of legislation in 1845 which related to clauses which should be adopted in the creation of companies by act of parliament (i.e. not part of the stream of legislation directly relating to limited liability companies) that referred to the preparation of an exact balance sheet which should show a true statement of the assets and liabilities and a distinct view of the profit or loss.

The 1844 Act was replaced by the 1856 Joint Stock Companies Act in which the accounting requirements were not mandatory, but it was suggested that true accounts should be kept, a just balance of profit or loss should be ascertained and the auditors should check the correctness of the balance sheet. In 1879 a Companies Act reintroduced the term full and fair balance sheet, while auditors were obliged to give an opinion as to whether the balance sheet gave a true and correct view of the state of affairs. In 1900 the full and fair signifier disappeared once again, leaving only the true and correct balance sheet which survived until 1947.

It could be argued that the change from true and correct to true and fair in 1947 was evidence of a shift in signified – that is that true and correct accounts would be different from true and fair accounts. The theory of signs (Saussure [1917], Culler [1982]) suggests that this is not usual: the signified normally changes quite independently of the signifier. Such little evidence as is available at the time also suggests that the move to true and fair was concerned only with providing a slightly more appropriate signifier, although it is conceivable that there were other motives.

The 1947 Act was based on the recommendations of the Cohen Committee, and the Cohen Report [1945] made clear that in general terms it thought much more information should be given to shareholders than had previously been the case. In this context it may be that there was an implicit feeling on behalf of the Cohen Committee that true and fair accounts were indeed different from true and correct accounts. However, the Report when recommending the shift to true and fair did not give any reasons.

Generally the Institute of Chartered Accountants in England and Wales is credited with making the suggestion to the Cohen Committee. Rutherford [1985] reports:

"In the course of being examined by the Committee, one of the Institute's representatives indicated that 'true and fair' was preferred to 'true and correct' because 'some people feel that in dealing with matters of estimate ... the word 'correct' is too rigid' It was thought (perhaps surprisingly) that 'fair' conveyed the same kind of general impression as 'correct'".

Walker [1984] quotes an editorial in The Accountant of 1st. July 1944:

"The word 'correct' has always been too strong because it implies that there is one view which is 'correct' as against all others which are incorrect. In published accounts there is no standard of absolute truth and the Institute's suggested amendment would recognise that the presentation of the figures can be only that which is in the personal opinion of the auditor 'a fair view'".

Viewed from the perspective of the professionalisation project of accountants (discussed in Chapter II), it could be argued here that both the Committee evidence and the editorial emphasise the judgemental aspect of accounting measurement and would tend to enhance the status of accountants. The notion that such measurement was not simply a matter of adding up numbers (to give a 'correct' answer) but involved professional judgement (to provide an assessment of what is 'fair') increases the mystique of accountancy and helps justify professional status.

Analysing the development of the signified is more problematical since it is abstract and changes take place slowly and at the margin. As in the case of the introduction of consolidated accounts cited above it is possible to observe some events which indicate in retrospect that a slight shift has taken place. In general terms the signified, the notion of periodic accounting statements, must have existed ever since people prepared financial statements. So in the time of Hammourabi in the third century BC one may presume a signified of this nature, even if it was not explicit, and one may therefore trace the signified back at least that far.

For the purposes of this study, it is not particularly useful to attempt to define the signified closely before recent times, but it is relevant to show that: (a) the signified generally undergoes gradual change; (b) its meaning at any one moment has been reached through an accumulation of shifts and changes across long periods of time.

The companies acts may be used to provide some crude indication of changes in the signified in so far as the changes in detailed accounting requirements are some evidence (albeit far from unambiguous) of changes in accepted opinion. These changes would not be synchronous with the changes in signified but would indicate retrospectively that a change had taken place.

It may be that changes in the audit requirements of successive acts indicate changes in the significance of annual statements: if the accounting statements do not occupy a prominent role in the relationship between the management and the shareholders the benefit derived from having them audited does not compensate for the costs. (Obviously there is an argument that the rise of audit indicates a fall in management morality, but evidence such as the level of fees earned from liquidations over the same period does not particularly support this notion).

The significance of the accounts to shareholders is presumably a component of the signified. Possible markers in the evolution of the signified in this respect would then be changes in the statutory audit requirement: the 1844 Act did not mention audit, the 1856 Act provided for a shareholder representative to audit the accounts, but this was not compulsory. Only in 1907 did audit become compulsory and only in 1947 was the shareholders' representative necessarily a qualified accountant. The conclusions that can be drawn from such a progression are far from unequivocal, but one conclusion is that the relative importance of the accounts in shareholder perceptions was increasing over this period.

Perhaps more reliable are the changes in specific accounting requirements over successive acts. Neither the 1844 nor 1856 Acts mention the composition of the Balance Sheet, although the 1862 Act provided a (voluntary) model of it. The 1907 Act calls for a summary of assets, liabilities and capital which will give the general nature of these items. In 1929 companies were required to provide a profit and loss account, but no details were specified, and to separate fixed and circulating assets. In 1947 details of the profit and loss account were specified and of the balance sheet, including definitions of reserves and provisions and their treatment.

Other traces of changes in the notions of what constituted an adequate set of financial statements can be seen in events such as the Garnsey lecture and the subsequent adoption of consolidated accounts (mentioned above), and the Royal Mail case in 1933.

In the Royal Mail case the company, supported by its auditors, was being sued for publishing a profit and loss balance which was misleading. The defence was that undisclosed transfers from reserves had indeed been made to compensate a loss but that this practice was normal amongst British companies and necessary to prevent panic amongst the untutored. This implies that prior to the case, at least, what was signified as the object of the accounts was based on a certain perception by managers and auditors of shareholder needs and likely reactions, and that that perception is substantially different from later perceptions of shareholder needs and reactions. The 1947 Companies Act prohibited such hidden transfers and moved further towards disclosing the detail of the profit and loss account.

At the time (Hastings [1962], Edwards [1976], Hein [1978]) the press was outraged at the directors' and auditors' attitude even though the court vindicated their view, and it was clear to the profession that the nature of the view given must change. The Royal Mail case can also be seen therefore as marking a moment where the signified was shifting.

In reviewing the history of the true and fair view it can be seen that the changes in the signifier generally take place independently of changes in the signified. The 1947 Companies Act signifier can trace its origins back to the 1844 Joint Stock Companies Act and is the inheritor of a British legislative tradition of expressing the spirit of what is required rather than a detailed prescription.

The signified, on the other hand, may be regarded as the inheritor of a longer tradition in that enterprise financial statements were in common use well before joint stock companies. The signified is flexible and capable of adaptation over time. Since it is abstract and not defined in either the literature or the law one can only observe changes in retrospect in terms of changes in the measurements made by accounting or the way in which these are presented, or in occasional events such as the Royal Mail case where the nature of the signified is disputed.

Contemporary Themes in the Signified

Given that there is no agreed or formal definition of true and fair which might help describe the signified, and that the signified is likely to change over time, any attempt to classify in detail the true and fair which was available in Britain for transfer to the European Community is not likely to be particularly fruitful. However there are themes which recur in 'official' statements made about it and in the literature and which can be used to provide an analytical framework for a consideration of the literature.

These themes are used in varying combinations, with differing emphases and different adjuncts by different writers to create their own true and fair signified. An analysis of these themes may give some insights and the different angles provided by different weightings may explain why there appear to be many possible interpretations. The main themes are: (1) the legal residual clause; (2) an independent concept; (3) generally accepted accounting principles.

By the legal residual clause is meant the sort of clause which is often added to statutes, contracts and other legal documents to cover circumstances other than those specifically foreseen in the other clauses of the document, and to some degree expresses the spirit of the agreement. In effect this kind of clause operates as a safety net put in by the creator of the contract to catch any eventuality not specifically foreseen in the other clauses and is not generally expected to be invoked except in unusual circumstances.

In relation to true and fair the signified implied by this would be that producing accounts according to the disclosure and measurement rules of the 1985 Companies Act would normally be sufficient to satisfy the law, but, in order to avoid the possibility of anyone using the detailed rules deliberately to present a misleading set of figures, true and fair provides a catch-all which obliges at least disclosure of further information or even departure from the rules.

The independent concept signified is one where the true and fair view represents a higher objective to be sought by accountants. It represents an ideal towards which accounting technique is evolving and which may be referred to resolve conflicts if setting standards or making decisions in individual cases. As such it is defined independently of existing accounting rules.

Finally true and fair as a code expression which stands in for generally accepted accounting principles is based on the idea that accounting principles do not represent a coherent, rationally consistent set of principles, but rather a set of pragmatic responses to measurement problems. The accounting rules define the true and fair signified rather than the signified having any independent existence as a concept or being used as a guiding principle by the light of which rules could be developed. Thus true and fair is learnt through a practical apprenticeship and is redefined slightly with any new development in practices.

These three themes are not proposed as being mutually exclusive, but rather as perhaps three poles of the true and fair idea, where different accountants locate themselves in different positions in relation to these three poles on the same plane.

Using the above themes as an analytical tool, the next stage is to consider how the existing material on true and fair relates to them. In order to do this the literature is approached on the basis of its source as between (a) legal comments ; (b) governmental comment; (c) official comment from professional bodies; and (d) the accounting literature in general.

(a) legal comment

One of the curiosities of true and fair is that no case has yet been heard in which a definition has been given. Chastney [1975] makes an exhaustive analysis of legal precedent going back to 1887 in the context of true and correct.

Chastney shows that successive judges have ruled that on the one hand the true and correct requirement implied an obligation to prepare a balance sheet which taken as a whole was not misleading, but that asset values should be "at least as good as there stated", so undervaluation was satisfactory.

In 1949 was the case of re Press Caps Limited where Somervell L.J. held that the inclusion of property in the balance sheet at its written down historical cost value of £30,000 was 'true' even though its market value was thought to be £90,000. Edey [1971] refers to this case saying that to the judge "the basis used for showing the freehold property in the balance sheet (cost less depreciation) was common practice; it did not seem to him that there was anything misleading in the balance sheet in this respect". Edey uses this case to support his argument that true and fair can be seen only in the light of accounting practice, at the same time the earlier precedents examined by Chastney suggest the residual clause approach. They appear to paraphrase the obligation to be true and correct as being to provide accounts which are not misleading, while linking this with the use of generally accepted accounting principles.

A 1986 judgement can be seen to have reinforced the link between true and fair and gaap. In a negligence case (Lloyd Cheyham & Co. v. Littlejohn & Co [1986] PCC 389) Woolf J. said:

"While Statements of Standard Accounting Practice are not conclusive ... they are very strong evidence as to what is the proper standard which should be adopted and unless there is some justification, a departure from this will be regarded as a breach of duty. It appears to me important that this should be the position because third parties in reading the accounts are entitled to assume that they have been drawn up in accordance with the approved practice unless there is some indication in the accounts which clearly states that this is not the case".

This judgement places true and fair firmly into theme (3) but on the grounds that users' expectations will be for accounts prepared according to gaap. This in turn implies that whatever might be the origin of the term, the dynamic nature of the signified will be such that it can only be interpreted in the light of current practice.

A similar opinion was expressed in 1983 when the Accounting Standards Committee published Counsel's Opinion on true and fair which it had obtained (Accountancy, November 1983). The Opinion stated that in the event of a Court being asked to decide whether particular accounts were true and fair the courts would "look for guidance on this question to the ordinary practices of professional accountants. This is not merely because accounts are expressed in a language which judges find difficult to understand ... The important reason is inherent in the nature of the 'true and fair' concept. Accounts will not be true and fair unless the information they contain is sufficient in quantity and quality to satisfy the reasonable expectations of the readers to whom they are addressed ... But the expectations of the readers will have been moulded by the practices of accountants because by and large they will expect to get what they ordinarily get and that in turn will depend upon the normal practices of accountants."

Although the Opinion took a firm view about the relationship between gaap and true and fair, it also expressed what appears to be a conflicting view that true and fair

"is an abstraction or philosophical concept expressed in simple English. The law uses many similar concepts of which 'reasonable care' is perhaps the most familiar example. It is a common feature of such concepts that there is seldom any difficulty in understanding what they mean but frequent controversy over their application to particular facts".

The contribution from the courts in identifying the true and fair signified over the years is relatively scanty, but does appear to demonstrate the changing nature of the signified with an increasing tendency to define the signified in terms of generally accepted accounting principles, leaning most heavily therefore on theme (3).

(b) governmental comment

This section considers comments emanating from sources involved with the government in one way or another and having some quasi-official basis, such as reports commissioned by governments or comments made by government officials. The true and fair signifier, of course, started its official life through just such a source, the Cohen Report [1945]. As discussed above, the Cohen Report does not provide explanations of its desire to change the signifier.

However, in refering to the desirability of specifying minimum requirements for the profit and loss account it says:

"We consider that the law should lay down minimum requirements as to the contents of the profit and loss, or income and expenditure, account calculated to ensure that it gives a fair indication of the earnings of the period covered by the accounts and that the auditor should be under specific responsibility to report on its contents. The account should be drawn up in accordance with accepted accountancy principles consistently maintained".

S.122 of the 1929 Companies Act (which was the act under review) deals with keeping 'books of account'. The Cohen Report said: "We consider that there are circumstances in which a company could comply with section 122 but, nevertheless, would not keep adequate books of account for the nature of its business. It seems to us impractical to set out in a statute all the matters with respect to which books of account should be kept, owing to the difficulty of compiling a comprehensive list which would cover the circumstances of every company, but we think that the section could be improved by adding introductory words in general terms ..." The Commission's recommendation was that the new clause should read: "Every company shall cause to be kept such books of account as are necessary to exhibit a true and fair view of the state of the company's affairs".

The evidence from the Cohen report is not overwhelming, but such as it is does suggest that the Commission identified the signified with gaap and also regarded it as usable as a residual clause.

The next governmental review of company law was by the Jenkins Commission. This followed the twin approach of Cohen, that true and fair was a residual clause expressing the spirit of the act, and that its elaboration was a matter of accounting principles. The Jenkins Report [1962] seems to treat true and fair as a residual clause but with overtones of an independent quality, theme (2) which expresses the spirit of the law: "The formula 'true and fair' seems to us satisfactory as an indication of the required standard, while it makes for certainty to prescribe certain specific information which the law regards as the minimum necessary for the purpose of attaining that standard".

The Report said elsewhere:

"Accounts prepared on the historical cost basis may need to be accompanied by supplementary information in order to give shareholders the true and fair view required by the Act. It is impossible to describe in general terms all the circumstances in which this will be so and it is manifestly impossible to devise a list of specific requirements which will produce the same result..."

The Jenkins Report went on to suggest that the professional accounting bodies could be relied upon to determine what constituted the necessary information to provide a true and fair view through their technical pronouncements, so the Report seems to combine all three themes, treating true and fair as a residual clause to be expanded by generally accepted accounting principles, but also conveying some intimation of the required quality. The user envisaged by the Report is clearly the shareholder.

The Department of Trade and Industry (DTI) has on two separate occasions in recent years made statements relating to the true and fair view: the first in January 1982 followed on from the Argyll Foods case on group accounts, while the second was in October 1984 on the question of the balance sheet presentation of unrealised profits within current assets. Neither statement does very much to amplify true and fair but both may be seen as instances where the DTI has acted to control situations where it felt that the development of accounting principles was too far from the letter of the law. For example its 1982 comment includes the general statement "It does, however, consider it axiomatic that any emphasis on substance over form must not be at the expense of compliance with the law".

In Australia, which followed Britain in changing to a true and fair signifier (Walton [1986]) the government commissioned a report (Walker [1984]) on 'The true and fair view and the reporting obligations of directors and auditors'. Walker takes the view that "in the absence of authoritative interpretations of the meaning of 'true and fair view', the significance of the phrase is, at best, ambiguous". He adds later "while there may be merits in having statutory requirements which are expressed in general terms, it could be that the 'true and fair view' goes too far: it is so vague (or 'slippery') as to be unenforceable". Walker seems to take the line that it represents "some higher standard of quality" useful for enforcing good reporting which might place his argument somewhere between themes (1) and (2) but he concludes that it is practically meaningless.

(c) official pronouncements from professional bodies

In fact the professional bodies have not shown much tendency to define true and fair, as indeed might be expected on the grounds of preserving indetermination. The ICAEW published a formal definition in 1958 and in 1985 in grappling with off balance sheet financing made certain other claims for true and fair, while in 1981 the ASC attempted to define the relationship between true and fair and accounting standards.

The ICAEW's statement N18, published in 1958, says:

"A true and fair view implies appropriate classification and grouping of items and therefore the balance sheet needs to show in summary form the amounts of the share capital, reserves and liabilities as on the balance sheet date and the amounts of the assets representing them, together with sufficient information to indicate the general nature of the items.

A true and fair view also implies consistent application of generally accepted principles."

The first part of the statement does no more than re-iterate the requirements of the 1948 Companies Act, but the second part is capable of a number of interpretations. One reading is that consistency in the application of accounting principles is central. Another reading might be that where generally accepted principles are not followed this should be disclosed in order to comply with true and fair. Or a stronger interpretation would be that the true and fair signified is synonimous with gaap – theme (3). In any event there is no mention of the possibility that true and fair might relate to some external quality. There is no discussion of users and uses of statements.

TR 603 was published in 1985 "to express preliminary views on the accounting issues raised by off-balance sheet finance and window dressing". This release says:

"Financial statements are required to give a true and fair view. This includes the provision of sufficient information, properly displayed, to enable a reader to assess the overall performance of a business, the full extent of its liabilities (actual and contingent) and its exposure to risks".

This release evidently sees true and fair as a definable quality. The purpose of the release is to persuade that although gaap does not include specific rules for dealing with the particular transactions concerned, accountants should apply the qualitative test in determining the accounting treatment.

In the context of this study, there are several interpretations of the comment: the strongest is that true and fair here is being taken in the theme (1) sense, the legal residual which expresses the spirit of the law. However it could also be argued that true and fair is being presented in harmony with theme (3): the comment could be expressed as 'the essence of generally accepted accounting principles is the provision of sufficient information, properly displayed etc.' There could also be an argument that the quality suggested is consistent with theme (2), but this is the least convincing in that the comment appears to be sited firmly within the existing framework of accounting rather than making any appeal to external qualities. TR 603 seems to fall somewhere on the axis between theme (1) and theme (3).

The Accounting Standards Committee issued a report in 1981 on 'Setting Accounting Standards'. The report included a section on the true and fair view. The introductory remarks disclaim on behalf of the ASC any absolute claim to determining true and fair, and indeed this is understandable given that only the courts have the power to determine anything in a legal sense, and also the position of the profession is that the individual circumstances of a company may not be covered by existing regulations. However, the ASC is at pains to point out the importance of standards in practice. It describes them as "highly influential and persuasive", which is understandable at a practical level in that all members of the professional bodies are required to observe the standards.

The argument proposed by the ASC is that true and fair is dynamic and "will change with the progression of accounting thought. Having regard to the way in which accounting standards are set – by a process of open debate – they can reasonably be regarded as an authoritative description of the state of accounting thought at the time". Leaving aside the question of whether standards are necessarily an authoritative description of accounting thought, the ASC appears to be expressing a theme (3) view of true and fair, an essence of gaap approach. If true and fair changes with accounting thought, then it must be inextricably linked with it.

(d) other accounting literature

An article by Cowan [1965] proposes a definition of the true and fair signified which is derived from the signifier. Saussure [1917] took the view that there need not be, and indeed generally is not, any connection between the signifier and the signified. The previous discussion on the history and evolution of the true and fair signifier supports the idea that there is no systematic link between them and that they have developed independently of each other.

Cowan notes that "Most statements about the 'true and fair' concept concentrate on its implications rather than its definition" and sets about to consider 'truth' and 'fairness' as independent qualities. He observes: "The Oxford English dictionary defines truth (of statements) as 'consistent with fact; agreeing with reality; representing the thing as it is.' I suggest that few accounting reports would measure up to these standards today ... it is perhaps time that we ceased to use the word 'true' in our legislation and in our audit reports ?" In his conclusions Cowan says: 5. Truth in its normal sense, truth in real terms, is a desirable attribute of these documents, and may well be recognized as the primary objective of accounting reports. 6. Fairness in accounting reports has to be related to some person or class of persons." Cowan's view would be a theme (ii) approach where true and fair is defined as a concept independent of any accounting consideration.

An early example of true and fair as generally accepted accounting principles is Edey [1971] who describes true and fair as "a term of art – a technical term". He elaborates:

"to the man in the street ... the words 'true and fair' are likely to signify that the accounts give a true statement of facts. He will be likely to associate 'facts' with 'actual profit' and 'actual values'. He does not realise that 'profit' and 'value' are abstractions. Before they can be conceived at all in any precise way they must be defined in such a manner that the definition contains in itself, or implies clearly, a method of calculation that could be followed in practice".

Edey describes accounting as

"an uneasy compromise between a wholly objective record of past cash receipts and payments, and a wholly subjective assessment of the current value of the enterprise ... the exact rules that are adopted are arbitrary and there is no theory or logical rule that can tell you where to draw the line ... the only test that can be applied is to ask which method is most convenient and useful, taking into account, and balancing, the interests of all parties concerned".

He takes the view therefore that in such circumstances it would be better to describe annual statements as being "properly compiled on a basis consistent with accounting practices normally adopted by the company". His argument in effect is that true and fair means in accordance with generally accepted accounting principles as it is used in financial statements.

Chastney [1975], whose exhaustive study was published as a research report by the ICAEW, seems to take the view that "in accounting the phrase has assumed a multiplicity of meanings" and that in effect has become meaningless. He seems to think that in fact some external quality along theme (2) lines should be sought but rejects any notion that true and fair as used implies this. He fears that "the recipient accords a literal meaning to true and fair and the sender a technical meaning" but by extension this would imply that true and fair as it is used has a theme (3) connotation – a distillation of technique. He does not focus strongly on users, referring to "investors (present and potential), creditors, employees, government, etc.".

The Scottish Institute also commissioned a work on true and fair (Flint [1982]). In his introduction Flint claims that true and fair is "a philosophical concept and not susceptible to definition by a comprehensive set of detailed rules [and that is] its most fundamental and characteristic feature". On the face of it then Flint would appear to be setting out on a theme (2) approach. However, the substance of his argument tends rather more to a theme (3) approach: "it would be wrong to pretend that the whole meaning and import of the 'true and fair view' which is given by accounts can be understood by a person other than one with a substantial knowledge of accounting practice. This is the level of understanding which is assumed by the concept of 'a true and fair view'".

Later he says: "it is the expression of an opinion requiring knowledge and skill and the exercise of judgment [but] it must be an expression of opinion within an established, credible frame of reference ... arrived at on a rational and supportable basis". Flint may be seen as siting himself in the theme (3) area, but insisting upon the use of professional judgment as a key element of the application of gaap. As regards users Flint is clear that shareholders rank first in importance on the basis of the Companies Acts although other interest groups must also be considered.

It is tempting to see Flint as in effect an apologist for the profession – his insistence upon the need for knowledge, skill and judgment are exactly the kind of claims which Larson's analysis of professionalization would predict, while at the same time he sites the process as taking place within an established frame of reference – generally accepted accounting principles. Although he calls this a philosophical concept it is not impossible to see that as a polite expression for something which could be described as a distillation of gaap, where this implies not only the rules but the ability to apply the spirit of gaap in situations not covered by specific rules.

Tweedie [1983] analysed true and fair and came more clearly to the conclusion that it represented "an enduring conceptual standard" which was discernible separately from conventional accounting – a theme (2) interpretation. Tweedie also recognised, though, a theme (1) element "a fail-safe device for the unavoidable shortcomings of prescription". Tweedie quotes Cowan's arguments which take 'truth' and 'fairness' as separate qualities and capable of application in their everyday sense and sees these somewhat as a guiding light which should be used to help determine accounting in the face of a changing environment where different interests emerge and different focuses.

Tweedie says that both director and auditor should ask themselves whether, if they were outside the company they would obtain a clear and unambiguous picture from the accounts. He says their picture must be a "faithful representation of the enterprise's state of affairs and profit or loss" (which, as it happens, is a translation of the French accounting term 'image fidele'). He recognises the shareholder as the traditional user but observes that the type of information needed by the shareholder has changed and the rights of "a wider public" have been recognised.

Bird [1984] follows the line of legal development of true and fair and comes to the conclusion that, as suggested by the 1983 ASC counsel's opinion, the true and fair view will be the one which satisfies a reader's reasonable expectations – which will have been moulded by current practice. This gives a theme (3) approach although Bird does also mention the theme (1) aspect. He observes that within the European context the theme (3) interpretation would mean that accounts which were true and fair in one country would not necessarily be so in another. Bird does not consider users at all.

Theme (3) is also arrived at by Rutherford [1985] albeit in his case he observes that accountants provide a true and fair view through the application of gaap, but should take note of the legal profession which claims to deal in law not justice, and find some less ambiguous term. He says that "in the absence of an explicated true and fair view the profession resorts to judgments arrived at 'in action' by individual members without any common frame of reference". By this he appears to mean that in the absence of a theme (2) type of definition of true and fair, accountants make their own judgments. This in turn can be interpreted as meaning they apply the distillation of gaap which they have received in training and amplified in practice (theme (3))

Rutherford observes that "a number of writers have suggested that meeting user needs somehow forms a part of presenting a true and fair view" but he feels that this is not helpful in 'explicating' true and fair. "The approach is not embraced explicitly by the profession ... it is doubtful whether the user needs model ... could provide a suitable criterion for the quality of published financial statements". There seems to be some confusion in his analysis between the general question of whether or not the person preparing accounts has a perception of the use of the accounts and whether this will influence decisions, and the specific question of whether true and fair systematically takes in user needs.

Conclusion

The argument has been advanced that the true and fair signified is dynamic and follows a continuing, if irregular, line of development independently of its signifier. The true and fair literature which deals with the way in which the signified is perceived has a number of strands to it and these have been analysed as (1) a legal residual clause; (2) a superior quality and (3) the distillation of generally accepted accounting principles. The signified may or may not involve an overt consideration of the users and uses of accounts but these have an important influence on the way in which accounts are prepared and are considered therefore to be a contributor to the true and fair signified.

It is not to be expected that one can arrive at a definitive opinion about the true and fair signified, because it is dynamic and to an extent it resides in the eye of the beholder. One can, however, consider the strength of the arguments that are advanced concerning true and fair. It seems that the most extreme position is expressed by theme (2) which proposes true and fair as an independently discernible quality. It is difficult to see how this relates to the real world in that the starting point has to be that true and fair were chosen deliberately by legislators to suggest independent qualities. This starting point ignores the possibility of signifier and signified developing independently and ignores the historical evidence that true and fair as an expression simply evolved from preceding legislation.

If the legislators had chosen true and fair because they wished to incorporate particular qualities, either the qualities are self-evident or the legislators would need to clarify the issue in order to achieve their end. If the qualities are self-evident, there should be no doubt about true and fair. But the legislators have not made attempts to clarify.

It may be intellectually desirable that true and fair should refer to some higher ideal but the evidence at the time the signifier was changed rather indicates that the signified was relatively well understood between those who were legislating and the profession concerned with operationalizing the law.

As far as the practical history of true and fair goes, the evidence suggests that the law intended to provide for a mix of prescribed minima and flexibility, with the profession being left the major role in elaborating the detail. In this context true and fair can be seen as including elements of both theme (1) and theme (3) and a good deal of the literature supports this interpretation.

The problem does perhaps become obscured because of the way in which accounting principles are elaborated. The signified is dynamic but does not necessarily develop at a regular pace nor in a consistent direction. If accounting change takes place only when a constellation of influences come together, then it is likely that elaboration will take place in a series of irregular movements, with apparently sudden movements being visible when a head of pressure builds up. As pressure builds, attention is focussed on the state of accounting at that moment, debate will be stimulated and perhaps alternative paradigms advanced. This may result in a clarifying of thought at that time and perhaps a development in gaap, such as the issue of a new standard. But such a movement does not, of course, change the nature of the gaap which was already existing except at the margin: the cutting edge of evolving practices pulls along a very long train of past decisions. It is therefore difficult to accept that realistically true and fair means any more in practice than the accumulation of accepted practices as they exist at any given time and in any given context.

The Indeterminate Nature of True and Fair

From the review of the true and fair signified it is evident that there is no clear consensus as to what is understood by it. As McMonnies [1977] puts it: 'we all know only too well that it is a concept meaning many things to many men, and it does not even have a statutory definition to support it'. Chastney [1975] concurs: 'Unfortunately there appears to be no single meaning which can be attributed to true and fair. In accounting the phrase has assumed a multiplicity of meanings. True and fair is what you make it. Each compiler and each reader applies his own interpretation.'

Parker [forthcoming] argues that the very flexibility of true and fair has allowed it to be exported to Europe: 'Whilst it is at first sight surprising that the Continental European countries have accepted such a concept it is clear that what they have really imported is a form of words which they are translating and applying so as not to disturb unduly what already exists'. This still leaves open, though, the question as to why regulators in general have permitted such a central notion to remain undefined.

In the previous chapter there was a review of the literature which discusses the circumstances which give rise to accounting change and the view was advanced that change takes place when a constellation of interests coincide on a particular issue, and that interested parties will attempt to influence debate to satisfy their particular needs. Arising out of that discussion, one may speculate that the indeterminate nature of true and fair could serve a purpose in facilitating debate, and also that it may serve the specific needs of the accounting profession in terms of emphasising the arcane nature of the profession's cognitive base.

Taking first the question of a narrow definition in relation to regulation, a flexible true and fair allows a wide debate, which would disappear if true and fair were closely defined in itself or constrained by a conceptual framework. Bromwich and Hopwood [1983] observe: 'It is difficult to see what incentives can be given to other bodies with interests in accounting standards to accept a conceptual framework when such an acceptance amounts to a reduction of their power in society as a result of the consequent narrowing of their right to comment'

It may be that true and fair is used as a mask for presenting interested arguments, where flexibility of the notion allows a wider range of argument. Zeff [1978] in discussing the rise of 'economic consequences' in US standard-setting commented:

'When corporate management began intervening in the standard-setting process to an increasing degree ... its true position was probably disguised. An examination of management arguments suggests the following range of tactical rhetoric. Arguments were couched in terms of:

1. The traditional accounting model, where management was genuinely concerned about unbiased and 'theoretically sound' accounting measurements.

2. The traditional accounting model, where management was really seeking to advance its self-interest in the economic consequences of the contents of published reports.

3. The economic consequences in which management was self-interested.'

In as far as true and fair is a synonym for the traditional accounting model in a British context, arguments about accounting issues could be presented as arguments about what is a true and fair view of a particular issue, or which view is truest and fairest amongst competing alternatives.

In this sense where it is used as a debating mask, its use is as a higher principle or as a guide in either a theme (ii) or theme (iii) sense. If it were closely defined, the situations where it could be used would be much more limited: the more flexible the concept, the more circumstances in which it can be used to support an argument. In this context there is a possibility that those who wish to preserve a foothold in accounting debate would have a motive in maintaining an indeterminate true and fair in order to maintain the widest possible foothold.

Expressed in practical terms, it can be seen that where a true and fair view is constrained, such as by the realisation principle, the constraining factor automatically removes some possibility of discussion. For example a criticism of historical cost accounting under inflation is that it does not identify holding gains and losses until realised. Managers could argue that their ability to create holding gains is an important part of their function and should be included in the measure of performance that is provided to shareholders on a systematic basis. However, true and fair is constrained by realisation and there is little debate about recognising unrealised gains.

The other aspect of the indeterminate nature of true and fair is its relationship with the status of the accounting profession in general and specifically with its cognitive base. The standing of accountants is improved if they are perceived as dispensers of an esoteric skill which is difficult to acquire, rather than as simple adders-up of numbers. In practical terms clients are more willing to pay high fees if they believe that a great deal of knowledge is required to provide the service they are consuming. It may be that the nature of the knowledge or skill of the accountant has a bearing on both earnings and status, and it is in the accountant's interest to stress the arcane nature of these.

In examining the growth of the accountancy profession in Britain Willmott [1986] states 'accountancy continues to be graced by a public image which, in stressing its technical, esoteric qualities, underplays the social and political formation of its practices and standards'.

This stress on the esoteric quality of the cognitive base of accountancy echoes elements seen by sociologists as part of the political weaponry of any profession. Larson [1979] advances the view that professionalization is a continuing process of "establishing and securing market control" and identifies a number of resources available to a profession to improve its situation. One of these resources is the cognitive base of the profession, where Larson observes "the more esoteric the body of knowledge and the more it approaches a new paradigm, the more favourable the situation is for the profession".

Larson argues that the professionalisation project involves the attempt by a profession to control both the supply of its professional product and the demand for it. The greater the control over demand and supply, the better the reward which can be obtained. In this context, the cognitive base, which is central to the professional product can play a role in promoting control. The more esoteric the cognitive base, the greater is the claim of the profession to be alone able to train new professionals (control of supply) and alone able to meet satisfy what is demanded.

In this context the use of true and fair in the accounting profession can be seen to contribute an esoteric element to its cognitive base and thereby help to maintain the profession's control of the market for its services. As Jackson [1970] puts it: 'By virtue of their character these areas of knowledge assume a mystery, a quality of the sacred whereby they take on a distinct mystique which distinguishes them from more mundane matters. The professional becomes necessarily the high priest of that area of knowledge in which he is acknowledged to be competent'.

The significance of indetermination in a profession has other implications, as is analysed by Jamous and Peloille [1970] who put forward the notion of an Indetermination/Technicality ratio as a theoretical means of scoring certain aspects of individual professions in order to make comparisons.

"The I/T ratio expresses the possibility of transmitting, by means of apprenticeship, the mastery of intellectual or material instruments used to achieve a given result. This makes it possible to appreciate the limits of this transmissibility; i.e. the part played in the production process by 'means' that can be mastered and communicated in the form of rules (T), in proportion to the 'means' that escape rules and, at a given historical moment are attributed to virtualities of producers (I)".

The I/T ratio itself encapsulates the idea that the more esoteric the knowledge which must be communicated to create professional producers, the more advanced the profession is in relation to the professional project, while the more its cognitive base can be reduced to a set of concrete rules the less advanced the professional project. In the case analysed by Jamous and Peloille, the training of French doctors, the indeterminate nature of the cognitive base is used by those in positions of power within the profession to exclude a group whose training has followed a different track from the traditional one. Jamous and Peloille advance the idea that the higher the I/T ratio, the greater the possibility of the existing hierarchy to preserve its position.

Boreham [1983] supports this view:

"There is ... a need to emphasize the indeterminate nature of professional practice and to promote ideological justifications concerning the nature and functions of the profession in order to head off appraisal and intervention by those who are not of the cognoscenti".

It may be, then, that accountants could have some interest in preserving an indeterminate true and fair as a means of bolstering their own power and influence, while all groups with an interest in the outcomes of accounting debate might have an interest in a flexible notion since that would preserve the widest access to debate. Following on from that, it would seem likely that, faced with the possibility of company law being shaped by the European Community, British accountants might see their position as being potentially eroded by it and this in turn would furnish one motivation for pressing for adoption of true and fair at Community level.

However, all those concerned with influencing the debate within the Community as a whole could also have an interest in adopting this indeterminate notion since on the one hand it does not narrow the debate, and on the other (as Parker observed) leaves a degree of flexibility for later at the stage of implementation by individual member states. Again, professional bodies in other member states might perceive the adoption of true and fair as providing a means of enhancing their own status

Conclusion

It is evident that the true and fair signified has many meanings and is used in many different ways. It may also be that those who use it are not always clear about what they understand it to mean, nor necessarily would they wish its meaning to be clear. Flexibility of interpretation seems to be a key feature of true and fair.

If flexibility is a key aspect, then it seems appropriate to consider whether that flexibility serves any particular purpose and there is any possible explanation for the existence of such an indeterminate signified at the centre of accounting regulation. There is little possibility of providing evidence on such an issue, but one may conjecture that a flexible concept is a useful mask in the context of debates about accounting. One may also observe that the sociological literature which deals with the process of professionalisation proposes a model in which an indeterminate cognitive base plays an enabling role in building the status and control of the profession.

If the true and fair view is implicated in the status of the British accounting profession, then it would be entirely predictable that the profession would make every effort to ensure that the true and fair view was not taken out of British accounting legislation through the operation of the European Community company law harmonisation programme.

CHAPTER IV

The True and Fair View and the Fourth Directive

The European Community has set out to harmonise company law in member states, in keeping with its objective of creating a unified business environment. The harmonisation programme is operated by the formulation of Directives which must be built into the national framework of each member state. Different directives have differing degrees of impact on accounting matters, but the Fourth and Seventh Directives are key pieces of legislation as far as company reporting to external interests is concerned. The Fourth Directive deals with the content and principles of annual accounts for individual companies, while the Seventh Directive extends these to groups.

When the first draft of the Fourth Directive appeared in 1971 Britain was not a member of the European Community but by the time the final version was approved in 1978 Britain was a member, and the overall objective of annual accounts was specified as being to give a true and fair view. The object of this chapter is to review the rationale for the harmonisation programme, the process by which the true and fair view came to be adopted and the meanings or expectations attached to the true and fair view in a Community context. The evidence will be drawn partly from interviews with people concerned with the process and partly from the literature.

The Community's Rationale

The Fourth Directive itself cites article 54 (3) (g) of the Treaty of Rome as its justification. This requires member states to harmonise their company law "to co-ordinate the safeguards for the protection of the interests of members and others ... with a view to making such safeguards equivalent".

Robert Coleman [1984], a Community official who was much involved with the development of the Fourth Directive, summarised the Commission's objectives:

"The fundamental, strategic objectives were essentially two-fold. First, they wished to remove the obstacles constituted by differences in their national laws of the full exercise of certain basic liberties consecrated by the Treaty, namely the freedom of establishment of companies and firms and the free movement of capital. Second, and in many ways the other side of the coin, they sought to co-ordinate the safeguards contained in national company laws in order to ensure that throughout the Community certain minimum standards at least figure in all national systems".

Ernst & Whinney [1979] in their appraisal of the Fourth Directive cite a memorandum submitted by the Commission to the Council of Ministers in March 1970 which sets out industrial policy. They summarise this:

"(a) The removal of the remaining barriers to the establishment of a single market embracing the whole Community.

(b) The creation of a unified business environment, involving the harmonisation of company law and taxation, and the creation of a Community capital market".

When the Commission presents a proposed directive for consideration it is also required to present a Statement of Grounds which expands upon the rationale for the proposal. The Statement issued with the first draft (1971) comments "considerable differences exist in the Member States as regards the legal requirements governing both the structure and content of companies' annual accounts. The particulars that the companies have to furnish are plainly at variance, both qualitatively and quantitatively, from one country to another". It goes on to observe that lack of comparability may distort competition and detract from the fusion of national markets. It may provide reasons for companies to establish themselves in a country where the requirements are not stringent and "finally, these differences may also be prejudicial to the rational orientation of capital investment in the Community to the extent that investors are not in possession of sufficient comparable information to take their decisions in full knowledge of the facts".

Coleman maintained that non-uniform accounts constituted a barrier towards trade across national boundaries since they stood in the way of "companies' shareholders, clients, suppliers, bankers". He also pointed out that for enterprises which were obliged to report in varying legal environments "the costs are real and cross-frontier activities are to a significant extent discouraged". At the same time the Commission was concerned that safeguards should be uniform:

"there are to be ... no legal havens where systematic 'laisser faire' could be used to secure economic advantage".

Raymond Barre, at the time vice-president of the European Commission, said [1972] "the Commission has been working for several years to improve and harmonise information for shareholders and for investors generally within the Community". He also said: "the lack of transparency in the market is often considered to be a major cause of their narrowness and instability. In the absence of sufficient information about the activities and future potential of companies, investors, who are using more and more the techniques of financial analysis, prefer to direct their purchases towards certain major international enterprises for which extensive information is available".

History of the Directive

The process by which company law directives are formulated and adopted is a lengthy one. The prime mover is the European Commission and in the accounting area the Commission did have available to it the 'Groupe d'Etudes', a body of representatives put forward by accounting or similar bodies in each of the member states which typically was consulted throughout the development of the Directive. (The Groupe d'Etudes merged in 1986 with the Union Europeenne des Experts Comptables, Financiers et Economiques to form the Federation des Experts Comptables Europeenne (FEE) but will be referred to in this study under its original name).

The European Commission identifies an area to be dealt with and commissions a report in the form of an outline draft directive

('Avant projet'). This is subjected to further debate and modification before being published as a proposed directive which is submitted to a lengthy consultative process. Formally the proposal is submitted to the European Parliament and the Economic and Social Committee who publish their views on the proposal. The Commission may then revise the proposed directive in the light of these submissions. The revised proposal is then submitted to the Council of Ministers for final approval.

In practice it is subjected to a further negotiating process in which representatives of the member states form a working party to agree the final compromises and produce the version of the Directive which receives formal approval. This working party is the main arena for final compromises. It will include permanent officials of the Commission and representatives of the member states – but some of those representatives may well be also members of the Groupe d'Etudes.

The negotiating process may also in the end involve the COREPER, the Committee of Permanent Representatives of member states, who are members of each state's diplomatic service. Unresolved points may be submitted to COREPER for a political solution if the working party cannot find an acceptable technical compromise.

In the case of the Fourth Directive the Council of Ministers working party became a permanent contact committee to which problems on the application of the Fourth Directive could be referred, thus providing a continuing monitoring of the adoption process in member states.

The first draft of the Fourth Directive

The main objective of this chapter is to observe how the true and fair view came to be incorporated in the Fourth Directive, and this will be approached by reviewing each version of the directive and the reactions to each version in chronological sequence.

The drafting process for the Fourth Directive started in 1966 with a committee under the chairmanship of "the eminent German accountant, Dr. Wilhelm Elmendorff" (Ernst & Whinney [1979]). This gave rise to the first draft proposed directive which was published in 1971. This proposal appeared to have been closely influenced by the German accounting requirements for public companies which had been revised in the Sixties as an element of the 1965 Aktiengesetz (Niehus [1972] Rutteman [1984]).

In general the thrust of the draft was towards prescribing very detailed financial statement formats and also laying down some basic valuation rules. However, for the purposes of this study the focus of interest is the way in which the true and fair view came to be incorporated as the stated objective of financial statements under the Fourth Directive, so the main interest of the Elmendorff draft is its second article which set out its general requirements.

Article 2 specified:

> 2.1. The annual accounts shall comprise the balance sheet, the profit and loss account and the notes on the accounts. These documents shall constitute a composite whole.

> 2.2. The annual accounts shall conform to the principles of regular and proper accounting.
>
> 2.3. They shall be drawn up clearly and, in the context of theprovisions regarding the valuation of assets and liabilities and the lay-out of accounts, shall reflect as accurately as possible the company's assets, liabilities, financial position and results.

From a British perspective paragraph 2.1 is in line with British practice, as is 2.2. Indeed, in as far as the true and fair view is taken to mean simply 'in accordance with generally accepted accounting principles' the 2.2 requirement of conformity to principles of regular and proper accounting could have implied a true and fair view. However 2.3 asks for 'accuracy' and that might be held to be even more ambiguous than the true and fair view. For example it is impossible to know whether in this context accuracy resides in the basic records and this requirement would be satisfied provided that the statements agreed with the basic records, or whether accuracy in the annual statements referred to the relevance of the overall picture provided for the user.

The version quoted above is the official Community text but the French version suggests a slightly different aspect. Article 2.2 refers to "une comptabilite reguliere et sincere" which has rather special resonances in a French context in that French accounts at that time were required to be "regulier et sincere". Article 2.3 refers to "une image aussi sure que possible", and although this has no special echo in existing French legislation it does seem slightly different from an accurate reflection.

Niehus [1972], a German commentator, translates 2.2 as meaning that the financial statements shall be prepared according to generally accepted accounting principles, but goes on to remark:

"Judging from the existing situation in Germany, this is a rather bold statement as it is still not universally agreed what 'generally accepted accounting principles' means ... the existing vacuum will need to be filled by the Common Market authorities".

The proposed directive was exposed to the European Parliament and the Economic and Social Committee for discussion, and the Groupe d'Etudes also published an opinion on the proposal. The European Parliament in which Britain was not represented at that time commented (October 1972) that the proposal seemed unlikely to provide accounts which gave a true and fair view and suggested that article 2.3 should be changed and that for "image aussi sure que possible" should be substituted "image fidele".

The Economic and Social Committee (February 1973) welcomed the 'progressive tendencies' of the proposition and in particular the objective of making annual accounts more transparent. However, in relation to article 2.2 and 2.3 the committee comments:

"(a) the expression 'aussi sure que possible' in paragraph 3, inspired by the German legislation, is not acceptable to the Committee because it is too imprecise. In its place the Committee proposes the expression 'une image aussi fidele que possible': even if a totally faithful view cannot result ... faithfulness is the fundamental quality which should be sought. Furthermore it corresponds to the Anglo-

Saxon formula 'true and fair view' which is based on the application of 'generally accepted accounting principles'"

The Committee went on to say that the article should be re-structured by reversing the order of paragraphs 2 and 3 so that the 'image fidele' requirement preceded the 'application of accounting principles' clause.

These two official responses to the first proposal throw an interesting light on the move towards a true and fair view. The literature generally accepts that the move to true and fair was motivated by British membership and was conceded by the Community under pressure from Britain, and yet the responses reviewed here were formulated without any direct involvement from Britain. Of course British membership had already been agreed at this time so it may be that commentators were simply anticipating, or again there may very well have been some lobbying.

It is certain that the Groupe d'Etudes had published its formal opinion on the proposal earlier (June 1972), and it is possible that this opinion had been influential in moulding the other formal responses. Here Britain had taken part in discussions and the opinion was prepared by a committee under the chairmanship of Dr. Kramer, who represented the Netherlands. This opinion also advocated the true and fair approach and suggested that the reference to following accounting principles (2.2) should be deleted and a new clause added after the true and fair view requirement which asked for clear presentation in accordance with the valuation rules and forms provided within the directive.

British reaction to the proposed Directive was unfriendly. Sir Henry Benson (now Lord Benson) is quoted in Accountancy (January 1973) as saying "the standards and procedures in the different countries are uneven. I believe that, taken as a whole, the United Kingdom is in the lead by a large margin". Edward Stamp (1973) was more moderate: "Sir Henry's pride in British accomplishments is of Churchillian proportions ... we must also be prepared to recognise and accept that comparison is inevitably a two-way process and there is much we can learn from others".

Parker [1973] notes that "with two exceptions [the fact that the proposed Directive did not cover group accounts, and the less onerous disclosures for small companies] the [disclosure] requirements are reasonably in line with current British practice" but added "much less palatable to British accountants are the detailed set of rules prescribed in articles 32 to 39 of the proposal".

On the French side some accountants were similarly unimpressed by the possible alternatives. A Franco-German seminar which was held in May 1973 and considered the true and fair view in relation to the audit certificate, came to the conclusion that it had no equivalent in French or German accounting, it would conflict with tax and legal prescriptions, and it was preferable that it should not be adopted (Revue Française de Comptabilite, November 1973).

The second draft of the Fourth Directive

By the time the Commission had issued a revised proposal in February 1974, article 2 had been altered:

2.1 The annual accounts shall comprise the balance sheet, the profit and loss account and the notes to the accounts. These documents shall constitute a composite whole. (No change)

2.2 The annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and results.

2.3 They shall be drawn up clearly and in conformity with the provisions of this Directive.

Although the revised version followed very closely what the Groupe d'Etudes had proposed, reactions in Britain were mixed. Lafferty [1974a] writing in Accountancy acknowledged the change but wrote that true and fair had been substituted for the requirement to conform to the principles of regular and proper accounting and:

"It is doubtful whether the subtlety of this distinction means much to our European partners, or even indeed to the Commission, which has consistently argued that this fundamental concept was already adequately contained in the original draft".

He went on to say "it is difficult to see how the virtually unchanged proposed standard layouts of accounts ... could ever be accepted in Britain in their present form without resulting in many companies being forced to publish two sets of accounts, one of which would be for the sole benefit of the European Commission"

It is interesting to see that Lafferty identifies true and fair with regular and proper accounting principles rather than the accurate reflection requirement, and that he comments that this is a subtle distinction. His suggestion that companies would feel obliged to publish two sets of accounts seems to imply that he thought users would either be misled or would not get information they needed from the Fourth Directive formats and valuation rules and would be better served by the existing British approach. In the article he complains about the requirement to write off goodwill, research and development expenditure and formation expenses, all of which would reduce the measured profit, and also speaks of balance sheets "cluttered up with masses of figures".

The following month Accountancy published a leader ("Learning to live with EEC Directives") which was rather more conciliatory. It observed that:

"Firstly, some accountants are disturbed by the whole question of Britain's entry into the Community ... secondly the whole concept of Directives by the Council of Ministers to individual member states ... is new and strange to all and abhorrent to many. Thirdly, although Brussels is only an hour's flying time from London, the average accountant knows surprisingly little about what is happening there".

The article noted that views about the objectives of the corporate report were different in different countries and introduced quotations from Tom Watts and John Grenside (both members of the Groupe d'Etudes) in defense of the harmonisation principle.

The final version

The second version of the Directive was then submitted to the Council of Ministers where final negotiations took place. In July 1978 the Fourth Directive was approved by the Council of Ministers. The negotiations within the Council of Ministers' working party had been protracted and had produced, among other things, a much expanded Article 2 where the true and fair view had been rather more hedged about than in the second version. The final article 2 is:

> 2.1. The annual accounts shall comprise the balance sheet, the profit and loss account and the notes to the accounts. These documents shall constitute a composite whole (unchanged from 1971).
>
> 2.2 They shall be drawn up clearly and in accordance with the provisions of this Directive.
>
> 2.3 The annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and profit or loss.
>
> 2.4 Where the application of the provisions of this Directive would not be sufficient to give a true and fair view within the meaning of paragraph 3, additional information must be given.
>
> 2.5 Where in exceptional cases the application of a provision of this Directive is incompatible with the obligation laid down in paragraph 3, that provision must be departed from in order to give a true and fair view within the meaning of paragraph 3. Any such departure must be disclosed in the notes on the accounts together with an exlanation of the reasons for it and a statement of its effect on the assets, liabilities, financial position and profit or loss.

> The member states may define the exceptional cases in question and lay down the relevant special rules.
>
> 2.6 The member states may authorize or require the disclosures in the annual accounts of other information as well as that which must be disclosed in accordance with this Directive.

The true and fair view has been demoted from 2.2 to 2.3, while 2.4. and 2.5 have been added and have the effect of qualifying the true and fair view. It is a moot point as to whether the change in placing reduces the strength of the true and fair view or not. Certainly paragraphs 2.4 and 2.5 make it quite clear that (a) the required picture of the company is normally obtained by following the Fourth Directive detailed prescriptions as to disclosure and valuation; (b) the picture given by following the Directive should be subjected to a test as to whether it is 'true and fair', if the answer is negative then further detail should be given in the notes; (c) in exceptional cases where a true and fair view is not given by following the rules, a departure is allowed, but this must be disclosed in the notes and its measurement effects specified; (d) a member state may even specify in its national legislation what may be held as exceptional cases.

The Battle for True and Fair

The analysis of the changes involving true and fair demonstrates that acceptance of it was not unquestioning. This raises the question as to what was at stake in the negotiations. Did the British insistence on true and fair change the objectives of the Fourth Directive, did it create new visibilities or were there other motivations in play ?

The main cited objective is the harmonisation of company law simply as an end in itself in the context of creating a Europe-wide economic unit. The chances of achieving harmonisation in a realistic sense would be influenced by the degree to which the model proposed differed from what was already practiced by member states, but the British were not against harmonisation per se and this objective remained unquestioned.

The more political objectives of the directive were (a) to establish a minimum standard of reporting (Coleman, van Hulle) and (b) to provide better information for investment decisions and thereby encourage a Community-wide capital market (Barre).

As far as the minimum standard is concerned, the higher the standard aimed for, the more difficult it is to achieve, but the British were not against this objective – British reporting standards being thought to be more rigorous than those of Community partners. This leaves the question of achieving better information for investment decisions. Raymond Barre [1972] said that harmonisation was intended to increase the transparency of company accounts and give investors the information necessary to make their decisions.

John Grenside, a British negotiator, interviewed in Accountancy (Lafferty [1974b]) is quoted as saying "I understand by true and fair view the presentation which is necessary for a reader fully to understand the meaning and implications of the figures and financial statements and explanations which are given to him" which would appear to be in line with the Community's objective.

Lord Benson was in no doubt that British reporting was better (Stamp [1973]) and Lafferty [1974a] thought that even the second draft was not helpful because of the standard layouts and valuation rules. However, if one looks closely at Lafferty's objections they come down to (a) the proposal required more disclosure than was normal at the time in Britain (e.g. a full breakdown of the profit and loss account from turnover through to net profit) and (b) companies would be required to write off goodwill and research and development expenditure, both of which practices were already followed in the US.

The original proposal called for 'regular and proper accounting', but laid down the basic rules for this, and an 'accurate reflection'. It is not altogether clear that these two taken together actually mean less than a 'true and fair view'. If, as is argued in chapter II, true and fair is a formula and it relates to generally accepted accounting principles at a given moment (i.e. it does not of itself imply any specific standard), there is no reason for 'accurate reflection' not to become a similar formula – a new signifier, but not necessarily a different signified. There is more clarity in the proposed directive in that it makes specific reference to accounting principles and defines basic rules, so there is no question but that the accurate reflection relates to a set of principles and is not an independent quality.

In fact Lafferty [1974a] acknowledges that the distinction is a subtle one and that the Commission "has consistently argued that this fundamental concept was already adequately contained in the original draft".

Support for the Commission's view that true and fair did not add to what was already there comes from the French side. Bertrand d'Illiers (interview 1987) is clear that in his view it is the basic rules which give the quality of the information. He quotes the case of Creusot Loire, a French company which went into liquidation several years ago: the company did not show any major losses in its income statement in the years prior to liquidation. Thanks to adopting changes in accounting methods, changes in valuation bases and all the possibilites available under French gaap at the time, it was able to produce accounts which were in conformity with the rules but were clearly misleading as to its real economic state. D'Illiers remarks that consistency of method and charging economic depreciation were not required at the time, but had they been, the company would have shown a very different position. It is the quality of the rules which is important.

It is not self-evident that the British desire for true and fair could be justified on technical grounds and it is perhaps relevant that the Accountancy leader (May 1974) cited the following reasons for difficulties experienced by accountants in coming to terms with harmonisation: (i) political opposition to the Community; (ii) opposition to the principle of European directives having the right to specify UK law; (iii) ignorance of the Community.

Stamp [1973] says "the Commission is heavily influenced by legal thinking, and it is perhaps not unnatural that they should tend to overestimate the efficacy of legislation in generating improvements, particularly in the area of accounting standards". He goes on to argue that specification of minimum disclosure and the requirement to appoint auditors are properly the preserve of law, while "all matters pertaining to accounting standards of measurement, valuation, and the whole question of income and value determination in general" should be left to the profession. Although the "legislature should be prepared to give its full support to the activities of the responsible accountancy bodies in their efforts to determine, promulgate, and enforce adequate accounting standards".

Stamp was advocating in effect a split of responsibilty which delegated a considerable area to the profession. It may be that this was a central issue in true and fair in that, prior to the Fourth Directive, the UK government was content to specify true and fair accounts and leave the profession to regulate measurement issues – to determine in effect what true and fair meant. The profession could be seen as being threatened with a loss of power and influence (with possible repercussions in the area of client relationships) through the Commission withdrawing some of its prerogatives, and the insistence on true and fair can be seen as an attempt to restore the profession's position.

Larson [1979] in analysing the growth of professions in capitalist society says "a collective effort was needed on the part of the actual or potential sellers of services to capture and control expanded markets". She goes on to analyse how, in the case of medicine, the professional market was made a monopoly with the aid of the state. There is a parallel with accounting services where the audit had become both a statutory requirement and a monopoly of the accounting professional bodies through state intervention in the United Kingdom. Stamp's comments, viewed from Larson's perspective, can be seen as proposing that the Community should create the market for services by specifying disclosure and then give the monopoly right to supply the service to the professional bodies.

Parker [1973], writing about the first draft observed:

"the experiment of an Accounting Standards Steering Committee is working well and few, I imagine, would like to see its authority severely circumscribed by legislation of the kind just described".

More recently Parker [forthcoming] has observed:

"British accountants were keener to export the concept of a true and fair view than accountants of other EEC states were to import it. While British accountants genuinely believe in the the inportance of the concept and its applicability, the export took place in order to protect its role in British accounting rather than in the expectation of other coubtries making radical changes in their accounting styles."

British accountants were very anxious about Community involvement in accounting matters, and their motivations could have been very many, ranging from the personal such as resistance to change, fear of the unknown, xenophobia, through to the economic such as defence of the profession and a desire to avoid the costs associated with any change in accounting procedures.

Whatever the motivations, the British accountants involved in the process of negotiating the Directive regarded the inclusion of the true and fair view as sufficiently important to form the basis of the major trade-off in the harmonisation process. In essence the negotiations were seen as being conducted between the Germans at one extreme and the British at the other. Paul Rutteman said (interview 1987) "the Germans would all the way through have preferred something much more rigid than the end product" but the specification of true and fair was obtained at the cost of accepting that the Directive should include the (German) formats and valuation rules as in the second (1974) draft. Tom Watts, a member of the Groupe d'Etudes at the time, defended this to Accountancy (May 1974) saying 'surely any kind of harmonisation, any kind of negotiation, involves compromise. One never gets all one wants in this world".

It can be seen that the subsequent negotiations did reduce the impact of this trade-off with on the one hand the true and fair view bound about with more restrictions (paragraphs 2.4 and 2.5) but on the other hand with the formats modified to allow some detail to be shown in the notes and some modification of key valuation rules such as the write-off of goodwill.

European Approaches to True and Fair

Once the true and fair view was established as part of the Directive, there remains the question as to whether what was signified by the formula in the European context was the same as what it signified to the British. On the one hand the only clear way of testing this is by empirical research into how different individuals operationalise the formula and therefore a review of measurement practices would be the relevant approach. On the other hand it is also possible to gain some insights at a conceptual level. Specifically the issues which can be seen are (i) the relationship between true and fair and the general rules; (ii) from whose perspective the view is intended to be true and fair (i.e. what users and uses of the information are envisaged); (iii) whether different accountants have different priorities when faced with accounting choices.

(i) True and fair and the rules

The relationship between true and fair and the general rules was a matter of contention throughout the negotiations and has remained contentious in the implementation stage. The Germans agreed to accept it only on the basis (Rutteman, d'Illiers) that it was minuted by the Council of Ministers that under all normal conditions a true and fair view would be obtained by following the general rules. For the Germans the existence of the minute enables them to interpret the Directive along the lines that the true and fair view will virtually never be permitted to override the general rules.

The Italians were for their part worried that companies would systematiclly use the true and fair override to avoid dislosures on a widespread basis. They demanded an amendment to the Directive which was agreed at the last minute by the COREPER, not by the working party, which is the last sentence of paragraph 2.5 "The Member States may define the exceptional cases in question (where a true and fair view is used to justify a departure from the general rules) and lay down the relevant special rules". In principle this clause is completely at odds with the underlying idea, in as far as it accepts that true and fair may over-ride the rules, but retains the right to stipulate rules as to when true and fair could over-ride the old rules. Since they have not yet finalised their implementation law, it remains to be seen whether they will make use of the clause.

d'Illiers (interview 1987) takes the view that true and fair as such is not particularly useful, what is more important is to have an adequate set of rules in the first place. He said "the users' interests are best served if the accounts are always established according to the rules in force. It is only if the application of the rules would truly give too misleading a picture on certain points that it is better to depart from the rules". He uses the metaphor of a photograph: the image is not a perfect representation of reality, but if the user understands the scale, the effects of a particular lens, the distortions or conventions of the medium, he can interpret the image.

Rutteman (interview 1987) explained that the true and fair view was "sold" to the Community on the basis that "applying general law in specific cases does not always work. It does happen from time to time, exceptionally, that the application of that law will produce the wrong answer; to that extent therefore you had to have some safeguard to make sure that you did not get nonsense accounts by virtue of the application of the general law to specific cases". He said that the need for better information was accepted and that "exceptionally, and understood to be very rare cases and probably only of application to individual companies – although that was not actually said to tbe the case at the time – in those exceptional cases you might have to depart from the law in order to show a true and fair view".

This understanding of the true and fair over-ride seems to be the one taken up in the final version of the Fourth Directive. Paragraph 2.4 says that where the application of the provisions does not give a true and fair view then additional disclosures should be made. Paragraph 2.5 then goes on to say "where in exceptional cases the application of a provision is incompatible (with the true and fair view) that provision must be departed from". The implication is that normally additional disclosure is the route to follow and only in the individual case should a departure be made.

However, even if this understanding of the relationship between true and fair and the general rules represented the generally accepted British position in the early seventies, the British profession went on, after the adoption of the Fourth Directive, to issue two accounting standards (SSAP 19 and 20) which relied upon the true and fair view systematically, not exceptionally. SSAP19 allowed property companies which held property as an investment not to depreciate it (contravening the Fourth Directive) while SSAP20 requires the recognition of unrealised gains on long term currency items.

Rutteman said:

"the Commission is uptight with the UK in that we had sold them the true and fair view on the basis of being something for exceptional cases, rarely used, and they had understood that to mean in the circumstances of specific companies. They had not understood it to mean in terms of general principles and to use the true and fair view generally in that way was something they could not really comprehend".

In fact the Contact Committee which was formed after the adoption of the Directive to monitor implementation has had some effect in influencing the way in which true and fair has evolved subsequently. In 1984 the British Department of Trade and Industry, responding to Commission pressure, wrote to the Accounting Standards Committee to point out that in its view "Section 149(3)(b) (the true and fair over-ride clause in the 1981 Companies Act) is a measure of last resort to be used only where there are special circumstances which demand departure and where the directors have determined that a true and fair view cannot be given by following the section 149(3)(a) approach of giving further information" (Letter dated 30 October 1984, published by the ASC on 27 March 1985 as part of a press release). The DTI appears to be insisting upon observance of the Fourth Directive interpretation of true and fair and this insistance has lead to a revision of SSAP9, valuation of stocks and long term work in progress.

(ii) Users and uses

To the extent that giving a true and fair view means providing a picture of a company which is not misleading to users of financial statements, one factor which could lead to different perceptions of true and fair is different understandings about the nature of the users and uses of financial statement.The nature of the users and uses of financial statements is not generally well defined in the British accounting literature. Burchell, Clubb and Hopwood [1985] chart the emergence of an interest in value added reports in Britain and its subsequent decline and evidently accounting perceptions of the identity of the users of corporate reports cannot be taken to be static or unproblematic. The authors observed that in the mid-1970s there was a shift in perceptions about companies: "Value added was seen as a performance criterion that put employees on a par with other interests in the enterprise ... where before there existed only the shareholder, there now stood a number of stakeholders, each of which is deemed to have a reasonable right to information"

Rutteman as an observer of the Commission noted that it " had a view, very strongly, that Anglo-Saxons were far too heavily oriented towards the shareholder and that what really it needed was a better balance between shareholder, creditor and the employee – of course there were other users, but those were the three (which were the focus)". He added "it was discussed quite extensively in the negotiations ... it was agreed that the accounts were not for one group of users, that they were general purpose statements".

Busse von Colbe [1983] observed that "in Germany, and some other countries, however, the protection of creditors (against bankruptcy) has first priority". In France (Scheid & Walton [1988]) tax measurement has been a major influence in the post war development of accounting while the system was originally designed as a system for controlling nationalised industry.

However, Parker [forthcoming] takes the view that true and fair is a sufficiently flexible concept for these attitudes not ot be significant: "It may be doubted whether a concept developed in a country where the main users of financial statements are investors is appropriate to countries where the main users are governments (as tax collectors), creditors and trade unions".

(iii) Different measurement criteria

This diversity of perceived users and uses interacts with measurement criteria, the choices made by accountants when faced with alternatives and in particular the relative strength of the prudence concept and the other principles. In the UK the profit and loss account is considered as a measure of performance, whereas in Germany its main function is as a measure of distributable profit. Given the German pre-occupation with creditor protection they are more focussed on minimising balance sheet values and distributable profit, which distorts the profit and loss account (Rutteman). Britain enjoys the privilege of not having its measurement of taxable profit tied to its shareholder profit but to other Europeans: "profit is what you're prepared to be taxed on today. The true and fair view is, in their eyes, still hampered very largely by thoughts of profit recognition for tax purposes".

d'Illiers said: "I think that the search for a picture which is not misleading should be stronger than the principle of prudence, [but] in France it is almost heretical to say things like that."

Gray [1980] came to the conclusion "it is clear from the analysts' yardstick that large companies in France and Germany are signficantly more conservative or pessimistic in their measurement behaviour than are large companies in the United Kingdom, which are relatively optimistic." He also noted "a uniformity of general accounting principles ... can only give a false sense of progress when what is significant is the way in which such a principle is applied".

Conclusion

The objectives of the Commission in promoting the Fourth Directive were to harmonise company law, but to achieve within that process a minimum standard throughout the Community, and a standard which was based on reflecting (within the confines of a set of accounting rules) an economic picture of the individual enterprise. There was no question of using the process to provide measurements for tax purposes or for economic planning purposes.

From a British perspective the project in principle should have been acceptable since its objectives were much the same as those already in practice in the UK. However, the methods used were based on a prescriptive German model which aroused anxiety in Britain, whether for personal or economic reasons and Britain insisted (with some support from other countries and institutions) that the Directive should require annual accounts to give a true and fair view, the approach used in British company law.

To the extent that the true and fair view allows companies to depart from the law it aroused opposition from other member states and was qualified in the final version of the Directive to minimise this effect. A result of this is that different member states still see the true and fair over-ride in different ways. At the extremes the Germans appear keen to avoid its ever being used, while the British have subsequently issued accounting standards which depend upon the over-ride for their legality.

A further element of difference in the nature of the view of a company presented in its accounts resides in the different appreciation in different states of the interaction between prudence and the other accounting rules. Where states lean heavily towards protection of the creditor and tax measurement as a basis, prudence will have greater impact than in an environment where performance measurement by investors is of greater importance.

While such underlying differences exist, a thoroughly harmonised understanding on true and fair is remote – but true and fair is itself such an indeterminate notion that it lends itself to adoption within the Community.

CHAPTER V

Accounting in France Before the Fourth Directive

The view of accounting change taken within this research is that it takes place on a continuing basis as new influences interact with old and new constellations of interest emerge from time to time (Burchell, Clubb and Hopwood [1985]). In attempting to discern the movements of change, a genealogical approach helps to identify changes in the arenas in which accounting impinges and with which accounting interacts (Loft [1986]).

In order, therefore, to observe the particularities of the adoption of the true and fair view in France as part of its adoption of the EC Fourth Directive, it is useful to commence the study at an earlier point in the history of French accounting. The end of the Second World War marks a useful starting point since the series of accounting regulations of which the adoption of the Fourth Directive is part originated at this time, and it also marks a point where attitudes to government intervention in business set out on a new footing.

The case will be advanced that a codified accounting system emerged as part of the government's armoury for controlling the economy, but within the diverse arms of the state the process was captured by the tax gatherers. Subsequent state and private initiatives created a need for a different type of accounting which could relate more to the financial market place, while at the same time the growth of the accounting profession and the desire of the profession to enhance its status also provided an impetus for a form of accounting which emphasised judgemental aspects.

The analysis will be broken down into several components: firstly the state's involvement with the economy and with accounting in the immediate post-war period, then the intervention of the state's tax arm during that period; secondly the change in the nature of state intervention in the 1960's and the restructuring of French business; and finally the growth of the accounting profession.

Post War Planning

Kuisel [1981] says that "The liberation and early postwar years marked the turning point for the economic order of twentieth century France. Renovation brought drastic change in economic institutions and the goals of public policy". Included in this change in institutions was the creation of the national accounting council (CNC) to prepare and oversee a codified set of accounts for nationalised industries, and the creation of a single professional accounting body, the Ordre des Experts Comptables et des Comptables Agrees (OECCA).

Kuisel characterises France at the time as follows:

"the country's economic situation in the late summer of 1944 was appalling and far more critical than it had been in 1919. Production had fallen to a third of prewar levels ... The objective of economic renewal became paramount, and structural change moved in the direction of a new liberalism marked with strong statist and technocorporatist tendencies".

"The accumulation of grievances against capitalism, the trauma of defeat, occupation, and extensive physical damage to the productive plant led to a compelling desire for a new departure. The solution chosen by the French was for the state to take charge; it assumed the tasks of managing and stimulating the economy, sustaining a constant flow of investment and 'liberating' the market in certain sectors".

At the risk of over-simplifying, the mood of the times was that a rapid rebuilding of the economy on modern lines was essential, and that this was to be achieved in part by nationalisation of a significant sector of the economy and by economic planning at a national level which would identify objectives and mobilise resources towards achieving those objectives. Much of the initiative of this approach is credited to Jean Monnet (e.g. see Parodi [1983], Miller [1986]), who devised new methods of planning: "His method ... associated economic interests in a process of collective problem solving. By virtue of having devised a solution the participants committed themselves to executing it ... the institutional expression of Monnet's approach was the eighteen Modernisation Commissions where planners assembled hundreds of businessmen, administrators, trade union officials, farmers, experts and consumers.' (Kuisel [1981]) This method of working became known as the economie concertee.

Within this new development of economic planning came three accounting developments, (i) the creation of a new system of national accounting, (ii) the creation of a system of accounting for nationalised enterprises and (iii) the re-organisation of the accounting profession.

The development of the national accounting system has been subjected to a considerable amount of scrutiny and is a key example of an accounting system being worked out at the heart of a political process in order to make visible economic activity so that it could be controlled by the state. However, its interest in relation to private sector accounting is perhaps tangential in that the national accounting plan itself was not properly operational until 1952 nor fully elaborated until 1960 (Miller [1986]) while the private sector was directly involved in (ii) the enterprise accounting plan which was first created in 1947.

The importance of the national accounting plan to enterprise accounting was that the state was actively seeking to use accounting as a tool for economic control, and that the enterprise accounting plan (the Plan Comptable General – PCG) was intended originally to provide economically useful data about nationalised enterprises which could be taken up within the national accounting system. After the war the government had nationalised Renault, les Houilleres. the Bank of France and four deposit-taking banks together with the electricity and gas utilities, and already owned the SNCF and Air France. Gauron [1983] observed: "the nationalisations which took place at Liberation, added to those undertaken by the National Front Government, gave the state control of the major part of the energy, transport, banking and insurance sectors".

Montet [1970] (President of the CNC) in reviewing the PCG and its connection with the national accounts said, speaking of the 1957 PCG: "the fundamental requirement [of the national accounts] was to be able to use in its own accounts the figures which were established for the individual company's own use. This led [the CNC] to take account of the necessity to make apparent the value added and the essential components of sources and applications of funds and the categories used by the national statistics".

The PCG was therefore crucially influenced in two ways, firstly that accounting categories should be standardised, and secondly that the analysis of operations should permit value-added to be measured – expenses and revenues should be analysed by type, not by function. This interest in types of transaction related to the distinctive way in which the national accounting system measured activity.

As Miller [1986] commented: "There are different modes of aggregation one can deploy in calculating the economic activities of the nation. One can, for instance, distinguish between an 'institutional' aggregation and a 'functional' aggregation. Expressed roughly, the former refers to an identification of groups of economic agents by privileging their socio-juridicial aspect (for instance individuals, private enterprises). The latter refers to an aggregation based on privileging the principal activity (for instance production, consumption or accumulation).' The French chose the former and this was developed into a system by which economic activity could be analysed on two planes, by type of transaction and by type of economic agent.

The precise way in which the inter-relationship between the national accounts and the PCG was worked out is difficult to discern since the original PCG pre-dated the formalised national accounts by several years. It seems likely that the initial work on both must have been done at the same time but that the PCG reached fruition much more quickly than the national system. The Germans had introduced an accounting plan in 1942 and some work on developing a national accounting plan had taken place at the same time. However, a collection of interviews with those concerned with formulating the national accounting system (Franáois Fourquet: 'Les Comptes de la Puissance') makes no reference whatsoever to the formulation of the PCG. The PCG was revised in 1957 and any divergences with the way in which the national system had evolved were corrected at that time, although Scheid and Standish [forthcoming] describe the revision as 'limited".

The original PCG was produced very quickly. A national body, the Commission de Normalisation des Comptabilites, was set up in April 1946. It consisted of representatives of government, the profession, management etc. and was asked to prepare the PCG. This was initially intended for use only by nationalised companies and private sector companies which were receiving state grants or other state financial support but was taken up in time in the private sector (Most [1971]). The PCG was published in 1947 and its parent was reformed into the Conseil Superieur de Comptabilite "whose task was to adapt the Plan as required for each industry' (Scheid and Standish [forthcoming]). "The Plan did not refer to accounting principles and only a few broad measurement conventions were indicated".

The PCG was revised in 1957, at which time the Conseil Superieur de Comptabilite became the Conseil National de Comptabilite and it was charged, in 1959, with developing the PCG by introducing industry-specific versions of which some 85 were eventually produced. The PCG was not compulsory for private sector companies, but eventually its use became very widespread. Beeny [1976] explains this as follows:

"(a) Everyone who ever undergoes any form of commercial training is taught it and has learnt how to use it.

(b) The requirements for the annual tax return are based on it. Thus accounts prepared according to the plan have to be prepared anyway, so there appears no reason why the books should not be kept similarly.

(c) Gradually plans comptables are being prepared for each industry, which are partially compulsory, though without any practical sanctions at the moment".

Montet [1970] remarked: "as far as the private sector is concerned, the extension of the Plan Comptable took place without any coercion. It was already almost universally applied when article 55 of the law of 28 December 1959 called for its adaptation for various economic sectors which involved private companies".

At this initial stage of development one can observe that the PCG was intended to provide a valid accounting tool for business management purposes but which would also provide statistics to enable the state as manager to control not only the individual business, but produce aggregated information which would be useful in the economic planning of the sector controlled by the state. Evidently the type of measurement required in such circumstances will not be the same as that which is useful to arms-length shareholders. The fact that privately-owned business was happy to use the system suggests that they similarly did not have a major need for information intended for private investment decision-making. This aspect will, though, be reviewed later in this chapter in the context of a review of business organisation in France.

Taxation

The State is not, of course, a single entity but rather a collection of separate agencies which do not necessarily work harmoniously with each other, nor necessarily consistently within each agency. While the PCG was designed to provide tools for economic planners and managers of state industry, it was also available to tax collectors as a measuring system of tax liability. Further, once the system was established for tax purposes it also became available for economic planning purposes in a different way – business could be encouraged to take particular directions or could be encouraged or discouraged through the medium of tax concessions and penalties. However, once the system has been tainted by tax measurement considerations it becomes less useful as a measure of economic activity.

As Mavridorakis [1970] observes: "Since the creation of income tax by the law of 15 July 1914, the legislators and the tax administration have exercised their minds in intervening in the domain of accounting". This has happened in a number of ways: in the absence of detailed definitions in the PCG the revenue authorities supplied definitions to tighten accounting for tax; the direct link between accounting profit and taxable profit has led to tax depreciation being applied rather than economic depreciation and also to a very prudent approach in order to minimise or defer accounting revenue; the use of tax incentives by the government has provided further departures from an economic measurement (Barrett & Roy [1976]).

Puyraveau and Descottes-Genon [1972] note: "tax law has created through statutes, regulations, jurisprudence and policy numerous rules on the presentation of accounts ... tax law tries to define a profit which will not be fraudulently reduced in order to avoid tax". They cite as examples a tax decree of 1946 which prescribes a certain balance sheet presentation, and also the compulsory application of the 1957 PCG by a 1959 tax statute.

They also observe that there is an inherent conflict between tax policy and company law in that company law seeks to avoid the possibility of paying dividends where insufficient profit exists, and to avoid the possibility of creditors being given a false impression of security. "In other words, tax law seeks to ensure that the accounts are not too pessimistic, and company law that they are not too optimistic".

The 1946 decree was concerned with fiscal revaluations of assets, and was the first of a series of such revaluations which were a source of distortion in accounts (Scheid, interview 1987). During periods of high inflation the use of historic cost depreciation will cause the profit measurement to be exaggerated. Some relief for this was provided by fiscal revaluations. Typically these operated on the basis that the tax authority (the 'Fisc') specified indices for different types of asset. Companies could revalue in line with these indices and then deduct depreciation in line with the revalued amount from their taxable profit – provided that the revaluations and depreciation were formally incorporated into the company's regular accounting.

The impact of tax depreciation has worked itself out in a number of other ways. In general terms the tax regulations fix maximum rates of depreciation in relation to specific assets/industries and require that for depreciation to be a deductible expense for tax purposes it must be used for all other accounting purposes. Companies will tend therefore to charge the maximum allowable for tax, irrespective of the economic measure.

Once the measurement system had become tax-driven it was further distorted as a result of the opportunities provided through differential tax policies to manage the national economy. Lagarrigue [1972] remarks: "it rapidly became apparent that by the effects of contraction, expansion and orientation which it could have on financial flows, taxation proved itself a remarkable instrument for the regulation and control of economic phenomena: sufficiently supple not to destroy private initiative in a capitalist society and sufficiently effective to bring private interests into line with public interests".

Mavridorakis [1970] traced the development of incentives through depreciation which were destined to encourage investment. In 1948 50% depreciation was allowed for building accommodation for employees, in 1951 accelerated depreciation was available for manufacturing plant, in 1954 an immediate deduction of 10% on the cost of modernisation, in 1958 special depreciation against the cost of shares in companies whose purpose was to build and run accommodation for letting. This use of tax allowances as an arm of economic policy was not confined to the period of reconstruction after the War but has remained a permanent element of French economic management with more recent examples being allowances for the construction of buildings used for research and development and for the purchase of assets used to combat water and air pollution.

The use of special provisions as part of economic policy is a further development which has influenced profit measurement. These provisions are more in the nature of a reserve in that they are general rather than specific and are shown as part of equity in the balance sheet, but they are deductible for tax purposes. Two major types are provisions for inflationary increases in stock (corresponding rather with stock relief in UK taxation) and provisions for outstanding foreign currency items. In order to obtain the tax relief available, the provisions had to be passed through the profit and loss account. Puyraveau and Descottes-Genon [1972] remark: "Of course, the measurement of profit is falsified. But their nature may be supposed to be known by anyone who holds themselves out as being competent to analyse accounts".

Tax regulations and profit measurement interact in another way in that the tax regulations specify maximum depreciation but not minimum, and did not require that the depreciation policy should be consistent. Mavridorakis [1970] quotes an extract from Citroen's shareholders' meeting on 29 June 1967 where the chairman said: "As far as rewarding providers of capital is concerned, the company had two possible solutions: either to use normal depreciation and not be able to maintain the dividend, or to reduce the depreciation and reward the shareholders in the required way. The board has chosen the latter solution ...'

Mavridorakis points out that neither management, nor shareholders nor other users of the accounts are able to rely on the measurement given. He also observes that the effect of the tax-drivem measurement is to destroy the value of the information fed into the national accounting system: "But the task of the statisticians and the national accountants is made singularly complicated as the fiscal depreciation has no connection with economic depreciation which is necessary for a sensible evaluation. So the national accounting operates a system of correction to calculate net profit ... such a method can only bring about disputes, disagreements and divergent opinions and provoke endless controversies".

Puyraveau and Descottes-Genon took the view that "it is impossible to draw up accounts, to prepare a balance sheet, without knowing the regulations of the General Tax Code and their interpretation". This in turn has an impact upon what is understood by 'sincerite' and 'regularite' in French accounting, which will be considered below.

The Fifth Republic

By the time that de Gaulle came to power in 1958, France had reached a new transition point. Its post-war restructuring had run out of energy, but the country had just become part of the Common Market and was facing the onslaught of competition from its partners. It had suffered substantial inflation in the immediate post-war years, but with the arrival of de Gaulle measures were taken to stabilise the currency and the French economy once again entered a period of strong growth.

However, some economists (e.g. Gauron [1983]) take the view that the post-1958 growth was significantly different in character from that in the immediate post-war period. They suggest that in the earlier phase much investment had taken place in the infrastructure and fields dominated by nationalised industry but much of the old French industrial structure had remained in place, preserved by a protectionist state.

With entry into the European Community much of the protection was swept away and industry was forced into radical restructuring through exposure to international competition. This brought about major regroupings which were given further impetus by the Vth. and VIth. national plans. The restructuring of industry created a need for different visibilities, for accounting much more in line with that in use in the international market places. During the same period managements became much more aware of the annual accounts as a possible means of communication with interested parties and trade unions realised that they could make use of such reports. These new roles for the annual accounting created pressures for change away from the tax-driven system.

The structure of industry in France was historically different from that of its major competitors. Levy-Leboyer [1976] analysed this and said that in the inter-war period: "French business organisations remained somewhat ill adapted. They were highly structured, led by authoritarian managers who demanded from their collaborators strict discipline but no initiative. They denied themselves both the security of any sort of cooperation with their competitors and also the facilities of outside credit – perhaps because they were afraid of losing control, and with it the possibility of handing down the firm to a successor of their choice". The average size of business establishments was small: Levy-Leboyer quotes a ratio of employers to employees of "slightly higher than 1 to 4 (for men) in the early 1920s". He also notes that business in France was highly dispersed: "transportation costs, consumer habits and probably the high proportion of rural clients contributed to the continued partition of the markets".

He observes that the pattern of business before the Second World War was a small number of very large companies and many small and medium-sized ones. While this is a basic pattern of developed economies he argues that "factor costs and socioeducational values in France have traditionally favored small-scale enterprise and that World War I and the wave of mergers in the 1920s contributed to an abrupt and unexpected concentration of business in a few key sectors [followed by a period of stagnation]. As a result this dualism has appeared to be more extreme in France than in other countries".

After the War the state set about revitalising the economy. One of its methods was through the expansion of nationalised industries. Kuisel [1981] says that "the nationalized companies successfully pressed for higher productivity, new technology, and more investment ... the example of public enterprise contributed to leading private industry toward a pattern of high investment and a decisive break with pre-war behaviour".

After the Monnet Plan came the Hirsch Plan. As Kuisel has commented: "Hirsch believed that the major contribution of his plan was this conversion of business in which many of its leaders gave up their pre-war cautiousness and insularity, their diffidence toward the state, and accepted the economie concertee and its practice of mutual enlightenment. Private enterprise clearly assumed a good part of the investment burden in the 1950s, reequipped plants, and expanded capacity".

In the private sector, though, the bulk of investment came from internally generated funds:

"The data available shows in any event that firms developed principally from internally generated growth: throughout the 1950s the rate of self-financing of private companies was in the region of 80%". (Gauron [1983])

In this context, therefore, such companies would have little interest in producing accounts for the purpose of raising external finance. Carre, Dubois and Malinvaud [1972] produce statistics to show that the proportion of total debt to total assets of all private enterprises in France was 20.7% in 1955 (but had risen to 33.9% by 1966).

However, the European Community and de Gaulle were to change the situation radically. As Parodi [1983] puts it:

"the accelerated implementation of the European Community treaty from the beginning of the 1960s produced the effect of the opening of a great window through which came the sharp wind of competition. From that moment the restructuring of the industrial sector would proceed at a great pace under the double influence of the dynamics of national and international capitalism and of the industrial policy of the state".

The main objective of the Vth. Plan (1964-69) was to establish a solid, competitive base for French industry. In Gauron's [1983] words: "the Vth. plan proposed nothing less than the constitution or reinforcement where they already existed of a small number of companies or groups of international size which could confront foreign groups on an equal footing". The intention was not only to encourage mergers but also to provide the business infrastructure for French companies which was available to their foreign competition.

To an extent government economic planning policy was shifting from defining which areas should grow to providing a platform from which industry could decide in which direction to expand. Amongst the measures taken was (July 1965) a reduction of tax on mergers, selective cheap loans to industry to rationalise production and substantial support for research and development expenditure in some industries. (Gauron notes that 67% of the research and development support in 1967, equivalent to 2.4% of GNP, went to only 8 companies: Thomson, CGE, Rhone-Poulenc, Pechiney-Ugine-Kuhlman, Creusot-Loire, CEM, Schlumberger and Air-Liquide).

At the same time the government took measures to encourage the channeling of private finance towards industry. In 1966 tax credits were granted for share portfolios, and banks launched unit trusts (SICAV). However there was a structural problem in the banking sector where since the nineteenth century the deposit-taking banks could not invest in industry or make medium to long-term loans. These restrictions were lifted in 1966 enabling commercial banks to take deposits from private individuals and make term loans to industry.

The moves towards a restructuring of industry and a re-direction of finance towards industrial investment were accompanied by measures to increase the accountability of industry, perhaps with the effect of making mandatory the agency costs which would be otherwise a disincentive to the owner-manger to seek outside finance. In 1966 the audit profession was re-organised by the state with the creation of the Compagnie National des Commissaires aux Comptes, who were charged with enhancing the attest function in relation to published accounts. In 1967 the government formed the Commission des Operations de Bourse, a state agency modelled on the US Securities and Exchange Commission, which was intended to supervise the financial markets (Decoopman [1980]).

At this time the government as economic planner was putting into place a reformed infrastructure to move French private enterprise more onto Anglo-Saxon lines, and in some ways it is surprising that initiatives were not taken at this time to produce a formal change in the PCG, rather than simply measures to improve observance of the 1957 Plan. However, the government's actions were confined to improving the quality of the attest function and to a lesser degree the quality of disclosures, rather than attempting any wholesale re-evaluation of the underlying code.

The government's restructuring efforts were met by considerable success, if not always in the form envisaged. A notable turning point was the takeover bid for Saint Gobain announced by BSN. Saint Gobain was a typical old French family-controlled firm, while BSN was a post-war empire built up by one of a new breed of managers. The French establishment was shocked, and the bid was eventually blocked through the intervention of the Compagnie Financiere de Suez, but in the course of the proceedings France experienced its first taste of a contested takeover: for the first time industrial affairs were news. For the first time, as Gauron [1983] puts it: "there was an unprecedented mobilisation of the media: press, radio and television. The studded doors of the secret world of business were suddenly thrown open to 'inform' shareholders who were suddenly needed, and to open factories and offices to the public".

The BSN projected takeover was thwarted, but it was the forerunner of a series of mergers which were to achieve the Vth. Plan's aim of concentrating resources (Parodi [1983] says that the top 500 French companies controlled 30% of French industry in 1964 and 47% by 1975) and it also served to bring to the attention of managers the utility of keeping their shareholders better informed.

Managers were also under fire from another direction. In 1968 France was shaken by a series of radical strikes, starting with a student protest in May 1968 which rapidly spread to industry. Ardagh [1982] says: "the strike was the explosion of years of frustration: an outburst against employers' aloofness and secretiveness, against the repetitiveness of much modern factory work, against the rigid and bureaucratic chains of command, the fear of delegating authority and the lack of group discussion which characterised French industry at all levels".

A side effect of this was that the comites d'entreprise which had been set up soon after the war became much more powerful and also demanded much more financial information from employers (d'Illiers, interview 1987). The comites were management/worker liaison committees and had been obligatory in all companies with more than 50 employees. (In fact some commentators cite them as a reason why small firms are unwilling to expand). In practice they had not achieved very much, one comentator observing that their main function was often to organise the annual dance. In the wake of 1968 employers began to realise that they needed to communicate much more with their employees and to use the Comite as the channel for this. The comites have become an important user of accounts and are usually advised by professional accountants. They now are sufficiently sophisticated in their use of accounting information, as d'Illiers observes, to pose a different kind of problem in that they sometimes receive more information than shareholders and take part in insider trading.

By the late 1960s therefore, company reporting was under some pressure from a number of directions within France. The government with its policy of building larger, internationally competitive enterprises had attempted to mobilise greater financial resources for companies but at the same time required a higher standard of reporting within the existing system. The possibility of takeover bids had come closer and perhaps encouraged a more communicative approach to shareholders, while old attitudes to trade unions were being forced to give way also to greater communication.

In addition to these pressures, some companies were subject also to needs arising from outside France, partly arising from a decision to seek finance outside the domestic capital market and partly from successful expansion overseas (interview Bellande 1986). The Gaullist-inspired liberalisation had allowed French companies to borrow on the international capital markets, but this in turn carries costs in the sense of a need to produce statements calculated according to US gaap in order to provide the sort of visibility expected in that market.

A feature of world trade which became particularly apparent in the seventies is the trend towards global markets. Stopford and Turner [1985] advance the idea that the distinctions between national markets are becoming eroded and that technological change and competitive pressure in sectors such as cars, electronics, computers etc. mean that only international companies selling standardised products with internationally known brand names survive in these sectors. They note a trend for multinationals to expand globally – British multinationals invest outside the UK, while the main investment within the UK is from foreign multinationals. This expansion has been accompanied by a similar international expansion of companies providing services such as finance or advertising for multinationals.

This trend is also apparent in France where Ardagh [1982] says "in the '60s and '70s France proved a favourite venue for the American or other investor ... [but] de Gaulle was not too happy about this dubious compliment. He saw threats to national independence... under Giscard the doctrinaire hostility eased and policy became more pragmatic". Following the pattern recognised by Stopford and Turner, increased inward investment has been accompanied by increased outward investment by the French multinationals. "Today Renault and Peugeot-Citroen have factories in Latin America, Africa and Eastern Europe; Bidermann, the big textile firm, is producing in Taiwan, Hong Kong and even in China; Thomson-Brandt builds TV sets in Spain and Singapore; BSN, a leading French food firm, is making yoghourt in Brazil; and so on".(Ardagh)

Many French companies started to produce a second set of annual accounts, often in English, for use outside France, both for trade partners, banks and for general public relations purposes. There was at the time no legal requirement to produce consolidated accounts, and the only established guidelines were those of the CNC which had no mandatory force. Consequently companies felt free to use whatever accounting conventions suited their purposes. At one extreme some companies retained Anglo-American accounting firms to produce and certify accounts according to US generally accepted accounting principles – for example UTA French Airlines, which had a major incentive in that it was buying US aeroplanes and financing them on the US market (interview Bellande 1986). Other companies produced group accounts for less specific purposes and sometimes selected conventions almost it seems at random. In general terms there was a trend towards producing 'international' accounts by large companies in addition to their PCG accounts. This can be seen as indicating that these companies recognised the utility to them of supplying information which gave a different visibility to that of the PCG and the tax-driven measurement framework.

During the period from the start of the Fifth Republic (1958) and the end of the 1970s, the structure of French business had changed radically with a shift to larger units of production and the creation of significant French multinational concerns. Attitudes to business secrecy and disclosure had also changed with the traditional idea of the firm as a secret, private family business moving to a model where business was larger and recognised the information needs of partners: providers of credit, arms-length shareholders and trade unions. The accounting needs of such disparate models are also quite different. Where the traditional firm used its annual accounts primarily for the purpose of minimising its tax liability, the new model needed different visibilities and satisfied that need by preparing a second set of accounts, generally along Anglo-Saxon lines, for external reporting purposes. Inevitably the old PCG was being decoupled from business needs

The Accounting Profession

So far in this discussion attention has focussed on consumers of accounting visibilities: the state (as nationalised industry manager, as macro-economic planner, as tax collector) and business interests. No attention has been paid to the technician involved in the production of the visibilities and the role of that technician in influencing those visibilities.

The role of the French professional accountant has been rather different historically from that of a British counterpart. Where in the nineteenth century the British accountant developed a business initially mostly concerned with liquidations but subsequently as a specialist auditor, intervening between shareholders and management with a role finally endorsed and supported by the state, in France the different business structure did not offer the same niche for the French accountant. Where French firms were typically small, family-run concerns the attest function had little use since there was effectively no need for agents. Scheid and Standish [1988] observe: "there was, at least within the private sector, relatively less need for the role of the auditor as an independent and potentially intrusive agent to limit managerial freedom. These are conditions in which we might expect accountants and auditors to be closely aligned with the interests of manager-owners".

Prior to the 1960s the audit branch of the profession had very little status, and the senior branch was concerned with essentially accounting consultancy, in effect specialist management consultancy. Formally the state intervened to re-organise the profession as part of the wholesale reform of the economy in the immediate post-war period. The Ordre des Experts Comptables et des Comptables Agrees was formed in 1945 by amalgamating two previously existing bodies. Reydel [1970] speaking as President of the OECCA at its 25th. anniversary celebrations said the government "wanted both to protect the public and to obtain guarantees of competence and honesty from the professionals to which it intended to give an important role in the country's economic life".

Most [1971] observes that by the 1930s accounting in France had become dominated by the law and was taught in law schools rather than in faculties of economics or business administration. He claims:

"The civil servants to whom was entrusted the postwar reconstruction appear to have appreciated the need to use accountants for planning and control, rather than the passive description of juridical observations. They introduced special legislation in order to create an organ of state which would be an alternative source of influence over the accounting profession. The aim of this agency was to foster the study of relationships between the firm and its environment, and between the various disciplines which contribute techniques to the management of investment and production, and which use accounts as an analytical method.

There is no evidence to throw light on the rationale for state intervention in the formation of the Ordre, but the context was one where the country was in the immediate post-war period and was engaged in a strenuous effort to re-establish an economy which had been under the control of an occupying army for six years. The abiding theme which runs through the post war planning period is the creation of the economie concertee where interest groups joined together in committees to deal with economic problems. The formation of the OECCA can be seen in that light as the formal creation of a unified interest group which would be needed to participate in the 1946 Commission de Normalisation des Comptabilites, formed only eight months after the OECCA.

From the point of view of the status of the accounting profession, though, French accountants were not given the carte blanche allowed British accountants by the British government in terms of determining detailed accounting measurement rules. The French state took a different line from the British state and this has had the effect of limiting the development of the professional status of accountants in France. As Scheid and Standish [1988] observe: "the French have not needed a major research breakthrough to tell them that accounting standards are driven by political interests and bargaining. The ideas that lay behind the creation and constitution of the Conseil made that clear from the outset 42 years ago. In consequence the accounting profession itself has not achieved the same degree of authority in matters of standard-setting as is the case generally in the English-speaking world and pronouncements of the OECCA on accounting matters are in the form of recommendations, not statements of standards".

Given that OECCA had been formed by the state and involved, albeit perhaps in a technical role, in the formulation of the PCG, the question then is how OECCA might see its interests to be best served in the future development of accounting. If we take Larson's model of the development of a profession – "If we view professionalization as a collective project which aims at market control, it appears, first, that this organizational effort brings together structural elements of different origins, which follow independent lines of evolution. On the one hand we have a specific body of knowledge, including techniques and skills; on the other, a market of services' (Larson [1977]). In essence the development of a profession is seen to be linked on the one hand to controlling and improving the supply of the product, and on the other hand to being able to control the demand for the product – and in both cases the support of the state can play a crucial role.

The professional product is itself intangible, and it is 'produced' indirectly by educating the producers of the service, so in this specific case the training of accountants is central to the growth of importance of accounting as a profession. But the nature of the product itself is also a key problem – in Larson's analysis, the more esoteric the specialist knowledge, the greater the claim to professional status.

The OECCA's attention in the early years was particularly given to building up the examination and training apparatus and it was only in the sixties that it turned its attention formally to improving the state of the accounting art. In 1963 the OECCA published a collection of the reports of proceedings of its annual meetings – which considered matters of practice as well as purely business proceedings. In 1965 it formed a committee to rule on technical questions not covered by the PCG. Scheid and Standish [forthcoming] take the view that "the OECCA was deliberately imitating the approach of the Anglo-American professional institutions toward accounting standard-setting".

Whether or not it was a conscious imitation, the move towards elaboration of the cognitive base of the profession can be seen as tending towards strengthening the status of the profession. Jackson [1970] observes that in developing the professional status "The professional becomes necessarily the high priest of that area of knowledge where he is acknowledged to be competent". For the OECCA to be undisputed high priests they would have to reduce as far as possible the influence of the Fisc on accounting measurements and also that of the CNC, as well as create a more esoteric brand of accounting which relied more upon their judgment and less upon a slavish observance of detailed rules. At the time that OECCA started to make technical rulings the CNC also started issuing guidance on the PCG and there is a case for viewing the OECCA initiative as an attempt to stave off inroads being made by the CNC.

In 1966 a new company law was enacted and this brought in the requirement that (from 1968) the auditor should certify that the accounts were 'reguliere et sincere". This move brought more attention to bear on the role of the auditor, but given that there was no established controlling body or professional audit standards, it was unclear what benefit this might bring. Accordingly the government moved in 1969 to establish a body with a formal monopoly of statutory audit – the Compagnie Nationale des Commissaires aux Comptes (CNCC). This body is also a professional examining body, but another route to membership is through taking the OECCA exams, and in practice this is normally the route chosen – the two bodies have nearly identical membership.

Collins and Pham [1983] observe that the audit function has been a subject of dispute over the years between the Justice Ministry and the Finance Ministry. "The commissaires aux comptes are under the tutelage of the Justice Ministry, which over a number of years has sought to make them auxiliaries and even to have them nominated by the courts. The justice argument centres on the commissaire's responsibility to disclose to the public prosecutor any punishable offence that a company may have committed and of which he has knowledge.' This orientation leads auditors traditionally to have more interest in the respect of legal form than in acknowledgement of economic substance.

From the point of view of the professionalization project, the creation of the statutory audit body can be seen as an important development in securing a regulated demand for the professional product. But in terms of predicting the future path of the OECCA along Larson's lines, one would imagine that it should be aiming to make accounting more esoteric, in order to increase the mystique and power of the profession, underline the importance of audit and take over the formal auditing body (which is likely to happen within the next two or three years). In terms of the OECCA's reaction to the Fourth Directive and specifically the true and fair view, it seems likely that OECCA's professional interests would be served by the esoteric nature of true and fair. Certainly if true and fair is a device used by the British profession to secure its own professional status, the OECCA exams, and in practice this is normally the route chosen – the two bodies have nearly identical membership.

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Sincerite et Regularite

It should be noted, though, that the French legislation already contained a similar expression, brought in with the 1966 legislation. It might be argued that the existence of such an apparently parallel device would make true and fair unnecessary. The requirement that accounts should be sincere et reguliere was (Scheid and Standish [forthcoming]) intended to increase shareholder protection, and one of the definitions of these qualities mostly frequently cited in the literature is, perhaps appropriately, that given in the 1969 annual report of the COB: "sincerite results from the correct evaluation of the accounting values as well as a reasonable evaluation on the part of management of the risks and losses in value' . "Regularite is determined with regard to the rules fixed by law, jurisprudence, the CNC and those professional organisations which are competent to define accounting principles".

An official of the Ministry of Justice addressing the annual congress of the OECCA defined the qualities as follows (Pleven [1970]): sincerite "confirms the correctness of those values which can be easily measured, and for those which are necessarily approximate, the good faith exercised by the management in their choice of accounting options and values' and regularite means that the accounting statements "are established in conformity with the rules of measurement and presentation currently in force".

Superficially sincerite and regularite provide a requirement which is not significantly different from some interpretations of the true and fair view. However, there are two factors which cause the application to be somewhat different in effect: sincerite is a quality required of the preparer rather than the accounts, and the generally accepted accounting principles which give regularite include tax-based approaches to measurement.

Neither the preparer nor the auditor are required under the terms of sincerite to consider the accounting statements as a whole: the auditor is expected to attest that the preparer has been sincere in measuring individual items. Sincerite is as much as anything a quality of the individual, not the accounts.

Generally accepted accounting principles in France at the time of the creation of the regularite and sincerite requirement were heavily conditioned by tax. Puyraveau and Descottes-Genon [1972] pointed out that tax law had determined many matters of presentation and measurement, citing fiscal revaluations, accelerated depreciation and special provisions. Consequently sincere and regular accounts were not concerned with presenting an overall economic picture to the user.

d'Illiers [interview 1987] gives an example of a steel company which in an annual report in the early 1970's published, on the one hand, the comments of the chairman saying that the company was in severe difficulties, and, on the other hand, a profit and loss account showing a break-even and certified as sincere et reguliere. The company and the auditors, when taken to task by the COB, pointed out that although the company had made a loss, the use of the full range of flexibility provided by releasing special tax provisions etc. had enabled this to be compensated. The accounts were therefore both sincere et reguliere, since they did not go beyond what was allowed by the law and practice, but were still misleading in their totality.

From the point of view of the professionalisation project, the way in which the sincere and regular view was operationalised, was not exploited particularly in a way which heightened the status of the profession. On the contrary it may be seen to an extent to have highlighted the auditor's management orientation identified by Scheid and Standish [1988] by allowing a misleading overall picture, as in the case of the steel company cited by d'Illiers above or indeed in the more public liquidation of the large Creusot-Loire conglomerate in the 1970s after several years of concealing trading losses through transfers from reserves. It may be that the profession needed a new judgemental quality to attach to their work.

Conclusion

Accounting in France was substantially reorganised immediately after the Second World War at the same time as a concerted effort was being made to revitalise and reconstruct the country's economy. The accounting reorganisation involved the creation of a unified professional body, a joint public sector/private sector committee to specify external accounting standards and the publication of an integrated accounting plan by the standard-setting body.

The accounting plan used a measurement approach for the profit and loss account which was designed to favour the measurement of value-added. The plan was compulsory only for nationalised or state-aided enterprises, but its use became more widespread in medium and large companies over a period of years until in 1966 it was adopted for tax purposes and it became virtually universal.

Although the plan was linked to providing data for the national accounting system and was part of the economic management system, accounting became more and more influenced by tax considerations as the Fisc stepped in to create accounting rules where the PCG was imprecise, tax was used as a tool of economic management and other distortions were built in. The result over a period was that annual accounts gave in effect a measurement destined only for one user – the Fisc. The link with the national accounting plan became more tenuous and figures had to be adjusted in a more or less arbitrary manner by any user other than the Fisc (including the national system) to gain any measure of economic performance.

The state started to take steps to reassert the relevance of other users, in particular shareholders, by bringing in the requirement for sincerite and regularite in 1966 and creating the Commission des Operations de Bourse in 1967. In practice the sincerite and regularite requirement seems to have had little effect in terms of privileging shareholders in that it was interpreted by preparers and auditors to mean sincerite within a framework of tax driven measurement. The COB, though, became a focus for pressure to improve the usefulness of annual accounts to users other than the Fisc.

Inter-twined with these elements, the business environment in France changed rapidly over this period. As Kuisel puts it "the modern business arrived late in France' – but it arrived during this period. Under the stimulus first of the Monnet Plan, then the Hirsch

Plan and entry into the Common Market as well as the subsequent Gaullist Vth. Plan, the French economy was rebuilt and expanded very fast. In the course of the expansion the old attitudes of management were forced to change, and new business structures were developed, many of which were more like US corporations than the old, family-run French business. These new corporations were active on an international scale, competing with other international companies, using international services and with reporting needs which were quite different from those of the old style of French business.

Trade union relations also underwent radical change in this period. The shock of the 1968 strikes led to a reevaluation of employee relations and an emergence of the comite d'entreprise as an important conduit for information. This in turn created a new demand for accounting information which gave a more independent measure of company performance.

The accounting profession, after creation of a state-sponsored body, built up its education and training function and began in the 1960s to extend its activities into developing and improving accounting principles. Over the period the profession grew in strength, benefiting from the re-organisation of audit by the government in 1966, but needing to make accounting a more esoteric, judgmental skill if it were to continue to improve its status as a profession.

Immediately after the war accounting had been developed in order to satisfy primarily the needs of the state, initially for economic management but subsequently more for tax measurement purposes. Annual accounts were seen as primarily tax documents. The 1960's were clearly pivotal in the development of financial reporting in France, since during that period different interest groups began to experience a need for different measurements – for new visibilities. The State wished to encourage the development of the stock market and created the COB which in turn pressed for a shareholder measurement.

Companies, as d'Illiers put it, recognised in the 1960s that they needed to communicate with both the outside world and their workforce and that the annual accounts could be a means of communication. Companies at this time started to produce consolidated accounts which were not subject to French legal requirements and were oriented towards "international' or Anglo-Saxon accounting practices.

The CNC started work on revising the PCG in 1971, at a time when new purposes for accounts were becoming important – for reporting to shareholders, for supporting relations with international finance and business, for reporting to employees. At the same time the profession had an interest in making the accounting process more esoteric and more judgmental in order to increase its own status.

CHAPTER VI

The True and Fair View in France

In the last chapter the view was put forward that by the end of the 1960s there had grown up pressure from a number of areas for change in French accounting. Government economic planners were keen to create large, Anglo-Saxon style companies and to channel finance to these firms, the firms themselves had some interest in providing better information for the investor and creditor group and employees. The accounting profession had an interest in creating a higher status for accounting and consequently its practitioners. These formed perhaps a constellation of interests looking for more sophisticated measurement and greater disclosure.

This constellation could be expected to be opposed by certain other elements. Within the state, the Fisc had an interest in preserving the old, tax-oriented measurement rules, while the Justice Ministry had an interest in privileging the auditor's function of ensuring compliance with the law which, in turn, gives the Justice Ministry an important role in company affairs.

The implementation of the Fourth Directive in France was done initially through a revision of the Plan Comptable, although the provisions were incorprorated into an accounting statute and reflected in subsequent legislation amending France's commercial code. The Fourth Directive, and with it the true and fair view, first reached a wide audience of French accountants, therefore, with the publication in 1979 of the Plan Comptable Revise (PCR), which was in effect an exposure draft of how the Directive was to be translated into accounting regulations. This was subsequently finalised as the Plan Comptable General 1982 (PCG82). The Fourth Directive accounting requirements were given the weight of statutory backing through France's first accounting law in April 1983. The true and fair view was operationalised for accounting periods from 1st. January 1984.

This chapter will review the adoption of the true and fair view in France, examining first the process of formulating the PCR and then promulgating it. It will then set out the details of the accounting changes which occurred and how these interacted with the previous requirements. Finally it will review how the true and fair view was received by the preparer, auditor and user communities and how far it may be seen to meet the needs of the different interest groups.

Formulation and Promulgation

By the end of the 1960s, accounting in France was clearly under some institutional pressure: the European Commission was formulating the Fourth Directive while in France the COB and the CNCC had been formed and the former had already undertaken a crusade to obtain more and better accounting information from listed companies. Internally the CNC was being advised by its sub-committees responsible for industry-specific variations of the Plan that the PCG57 no longer satisfied the information needs of business (Dupont [1981]). In 1971 the Ministry of Finance formally asked the CNC to undertake a revision of the Plan.

The CNC, with over 100 members, is constituted in such a way as to provide an opportunity for many interest groups (different branches of government, business, trade unions, COB, OECCA, CNCC, legal profession etc.) to have a voice. As Scheid and Standish [1988] remark: "The French have not needed a major research breakthrough to tell them that accounting standards are driven by political interests and bargaining. The ideas that lay behind the creation and constitution of the Conseil made that clear at the outset 42 years ago." Consequently the process of formulating a revised PCG would have taken place through a mechanism which allowed all the interests identified to put forward their case directly, although (interview d'Illiers [1987]) they might also do so indirectly by lobbying what were perceived as major players such as the COB.

To some extent the debate within the CNC was inevitably constrained by the working party on the Fourth Directive. Some of the CNC members were also members of either the Groupe d'Etudes or the European Commission working party or both, so there was feedback between the European standard setting arena and the French one, but clearly the French could not sensibly complete their own revisions ahead of final agreement on the Fourth Directive. Consequently although revision was started in 1971, close to the time of the publication of the first draft of the Fourth Directive, the PCR was not officially finalised until 1979, following on the 1978 approval of the Directive by the European Council of Ministers.

In fact the first publication of the details of the proposed new Plan occurred in May 1978, before the Fourth Directive had received the official endorsement of the Council of Ministers. An issue of the Revue Franâaise de Comptabilite was devoted to a presentation of it, complete with an introduction from the President of the Conseil National de la Comptabilite, an explanatory statement from the president of the OECCA's technical committee and finally a discussion of the influence of the Fourth Directive from an official of the Justice Ministry who had been one of the French delegates to the EC Council of Ministers working party.

The President of the CNC claimed (Dupont [1981]) "the new Plan is a collective work, conceived in the context of a European harmonisation of accounting. It has been created for numerous interested parties. None of these has been able to impose their needs at the expense of others. The fact that it has received the unanimous support of the members of the CNC shows that the progress made in general has been recognised as worthwhile for each individual." In effect the President was saying that there was 'something for everyone' in the PCR and therefore everyone should accept it. To what extent there is support for his argument will be reviewed in a later section of this chapter.

What is evident from the publications of that period is that there was a great deal of institutional support for the PCR and then the PCG82. Several of those closely involved with both the CNC and the formulation of the Fourth Directive, such as Bertrand d'Illiers of the COB were very visible in the subsequent publicity which was given to the new plan. It may be that in this way they were able to privilege their own view of what was signified by the new approach. Opportunities to influence what was understood by the new accounting (and the true and fair view) existed not only in the formal arenas of the European Community due process and the CNC, but also at the level of elaborating the practical implications.

Many journals with a readership concerned with annual financial statements (accountants, lawyers, business managers, financial analysts) published special features on the new Plan (e.g Revue Française de Comptabilite [November 1982], Revue des Societes [1984-1]). Some of these were in the 1978/79 period while the bulk occurred around the time of the formal adoption of the PCG82. These reviews frequently used people who had been concerned with the preparation of the Plan.

A typical example would be issue 44 (Spring 1981) of Analyse Financiere. The whole issue was devoted to the Plan and consisted of (i) an article where the President of the CNC (Dupont) explained the motives for revising the PCG, (ii) an academic (also a member of the CNC) described the PCG and the influences which had contributed to it, (iii) two practising accountants discussed the importance of the true and fair view in relation to the PCG, (iv) Bertrand d'Illiers wrote about the protection of shareholders, and (v) two financial analysts (one a member of the CNC) presented an appreciation of the opportunities for financial analysis offered by the PCG.

Whether by chance or not, the device of involving a wide set of interest groups in the preparation of the PCG82 appears to have had the effect of (a) allowing the Plan to be presented with a unified front by those interest groups, and (b) providing a body of informed writers and speakers to participate in the promulgation and elaboration of the Plan in the accounting and user communities thereafter. A particular consequence of this is that although the true and fair view remained undefined in the regulatory literature, it was the subject of much debate. In turn this debate may have helped ensure that attitudes within the accounting community were shifted so that true and fair accounting was perceived to be something different from what had gone before, rather than simply absorbed as a new label for the same accounting as before. In terms of semiotics, the debate about what true and fair signified would have served to determine what members of the culture group using the term would understand by it.

Although the professional literature shows very little evidence of debate about true and fair and the nature of the revisions which were desired in the revision period, 1971-1978, once the PCR had been published, there followed a major effort both in terms of articles and conferences to disseminate information about the PCR and discuss its implications. Many of those who had been involved in preparing the revision, both at European Community and national level, took a prominent role in the dissemination process, and may well be responsible for ensuring that the PCR and subsequently PCG82 were conveyed as involving a fundamental change in attitudes.

Technical Change

"The accounting law which has been awaited for so long was adopted in April 1983 (law 83 353 of 30 April 1983, JO 3 May 1983) and has permitted the harmonisation of our internal laws with the requirements of the Fourth European Directive" (Kerviler [1983]) .

The Plan Comptable General 1982 both implemented the terms of the Fourth Directive and permitted a revision of the PCG57 which had been long awaited. Because it combined both internally generated and externally-generated reforms its effects are more far-reaching than a simple adoption of the Fourth Directive would have been, and occasionally there was some doubt about its objectives:

"(The PCG82) is often presented as a modernisation of the old Plan and almost uniquely that. Certain authors mention the Fourth European Directive only in passing: a constraint which limited the marvellous plans for reform, or a Trojan Horse of Anglo-Saxon concepts (the true and fair view, notes to the accounts). But above all the objective of the new French dispositions, the PCG, the accounting law and the decree, is to respond to the changes made necessary by the European decision to harmonise the annual accounts of companies." Boussard [1984]

Scheid and Standish [forthcoming] identify the important elements incorporated into the PCG82 from the Fourth Directive as follows:

"This latter involvement (in developing the Directive) influenced the thinking of the CNC, especially after the accession of Britain to the EEC in 1973, resulting in the incorporation into the revised 1979 Plan Comptable General of the following three important concepts:

(1) True and fair view (image fidele) as a criterion for the annual accounts;

(2) Explanation of the annual accounts by attachment of notes (annexe);

(3) Reference to accounting principles to explain the accounting policies adopted."

Overall one can identify the following changes to accounting requirements which were brought in by the PCG82:

1. The true and fair view as the objective of annual statements.

2. Explanatory notes as part of the accounts.

3. Distribution of an annual report to shareholders.

4. Specification of accounting policies in notes.

5. Disclosure of the impact of tax on asset values and profit calculation.

6. Replacement of two operating statements with single income statement (compte de resultat).

7. Change in groupings of balance sheet classes.

8. Change in some existing account names and numbers.

9. Introduction of different levels of disclosure for different sizes of enterprise.

From a French perspective a further very significant change was the decision to incorporate the new requirements in a new law, whereas previous Plans Comptables had been simply promulgated by ministerial authority. The 'true and fair view' requirement was also built into a new commercial code in 1984, requiring managers to ensure that the accounts were drawn up with this objective and providing legal sanctions in the event that this was not complied with. One result of this is that an auditor, if of the opinion that a company's accounts do not provide a 'true and fair view' is obliged to communicate this fact to the public prosecutor and the management face a potential prison sentence.

The legal status of the 'image fidele' is not necessarily germane to this study in that the fact that an accounting law was passed does not in itself mean that compliance would have been any less if normal PCG procedures had been followed. The important point for these purposes is what Fourth Directive requirements also appear in the PCG82.

Overall the effect of the changes brought in by the PCG82 and the new accounting law is to provide considerably more information than before and to display the information in a more easily understandable manner. A major innovation (caused by the Fourth Directive) is a requirement to separate out the distortions caused by tax-driven measurements, although the less obvious distortions will undoubtedly not disappear overnight. In detail the technical changes were as follows:

True and fair view: "Paragraph 3 of Article 2 of the Directive: 'The annual accounts shall give a true and fair view of the company's assets, liabilities, financial position and profit or loss' is more precisely put in the French law: 'The annual accounts shall be regular, sincere and give a true and fair view of the assets, liabilities, financial position and profit or loss of the enterprise'." (Kerviler [1983])

The French version goes further than the European version by retaining the previously required qualities of regularite and sincerite. This of course opens up the possibility of debate both as to whether there is conflict between the old qualities and the image fidele and whether the image fidele has a meaning which goes beyond that of sincerity in particular, apart from the question as to what the French accountants understand by image fidele.

The accounting law specifies (art.2.I) 'When the application of an accounting rule is not sufficient to give the true and fair view mentioned in this article, supplementary information should be given in the notes to the accounts.

If, in an exceptional case, the application of accounting rules fails to provide a true and fair view of the assets, liabilities, financial position and profit or loss, the rules should be departed from; this departure should be mentioned in the notes and an explanation given, together with an analysis of its effects on the assets, liabilities, financial position and profit or loss'.

These paragraphs take up the requirements of Article 2, paragraphs 4 and 5, of the Directive and reflect the understanding of true and fair that supplementary information should normally be the first resource used and that only in an exceptional case is a departure from the rules envisaged. This seems to be in line with EC working party's understanding of the operation of true and fair.

Notes to the accounts: The accounting law provides for the preparation of notes to the accounts (annexe): 'the annual accounts will consist of the balance sheet, income statement and notes: they form a composite whole' (Article 2, paragraph 1 of the Directive).

The accounting decree (83.1020 of 29 November, 1983) and in particular Article 24 specifies what information should be contained in the notes to the accounts. Article 24 also includes several items to be disclosed which are not called for by the Fourth Directive:

- the nature, amounts, and accounting treatment of exchange differences expressed in the national currency of items denominated in foreign currencies (para. 5);

- where current assets include treasury investments, the difference between the balance sheet value and the market value at balance sheet date (para. 10);

- the identity of any company which prepares consolidated accounts in which the accounts of the company under review would be included (para. 14);

- the amount of commitments undertaken in respect of pensions, supplementary pensions etc., detailing those for which a provision has been created, and those which have been undertaken for the benefit of the directors (para. 16).

The idea of producing notes to the accounts is a major departure for France, and some accountants regard it as the most important single element of the harmonisation process. For example Mullenbach [1984] speaks of:

"...this annual document which certainly constitutes the most effective innovation of the new accounting plan...

The essential difficulty stems precisely from the fact that the notes are an 'open' document which calls for judgment rather than an automatic response, and for this reason it is a completely new document for a code law country like ours: it is for the directors of each company, subject to the controls of the auditors, to appreciate what is necessary and sufficient to give a true and fair view of the assets, liabilities, financial position and profit or loss."

Annual report to shareholders: Article 46 of the Fourth Directive requires the publication of an annual report which should include:

- Para. 1 : at least a fair review of the development of the company's business and its position;

- Para. 2(a) any important events which have occurred since the acounting year-end;

- Para. 2(b) the company's likely future development;

- Para. 2(c) activities in the field of research and development;

- Para. 2(d) information about the company's acquisition of its own shares.

These requirements are introduced by article 3 of the accounting law, which follows the Fourth Directive closely except that the French law calls for a review of the company's situation rather than a fair review of its development and situation.

It is difficult to evaluate the impact of these disclosures in a precise manner since many companies will have made more than the minimum legally required disclosures before the implementation of the Fourth Directive. On paper the impact would be significant since companies were not obliged to send accounts automatically to shareholders – they were only required to lodge them with the commercial court, and any supplementary information would be scanty and selective. However, many companies used to produce more than the statutory minimum, so all one can say is that the standard of disclosure and the uniformity of disclosure should both have been improved.

Disclosure of accounting policies: commentators have noted that some French companies were inclined previously to change their accounting policies from year to year; the requirement to disclose policies, allied to the Fourth Directive specification of consistency as one of the basic principles to be applied could be expected to have some impact. There was no mandatory disclosure of policies prior to the Fourth Directive and there is a suggestion from the Commission des Operations de Bourse, for example, that policies were frequently changed. In the annual report of the COB for 1983 the following comments were made:

"The other major progress will result from the reaffirmation, in a manner much more marked than in previous regulations, of the principle of consistency of method in preparing the annual accounts ... it is not possible to deviate from this except in certain circumstances and then the justification for the change must be submitted to the auditors".

Article 2 of the Accounting Law prescribes consistency of method, allowing change only under 'exceptional circumstances' and then requiring an explanation and analysis of the effects of the change in the notes to the accounts. Article 24 of the Accounting decree specifies disclosure of accounting policies.

Impact of tax:Article 35 para. (d) of the Directive provides for disclosure of value adjustments of assets for tax purposes. This is taken up in article 24 of the Accounting Decree.

The CNC issued an opinion in 1984 (no.25) that where companies had applied depreciation policies based other than on an economic depreciation, the excess of accumulated depreciation between that applied and economic depreciation should be shown in the balance sheet on the liabilities side as 'Amortissements derogatoires'.

Clearly in a regime where tax-based depreciation had been the norm this requirement had the potential to change asset values substantially. However, its impact in practice is bound to be limited by the extent to which preparers are willing to identify economic depreciation as being different and to which auditors are willing to acquiesce. The clause provides the opportunity for those preparers who wish to boost asset values to do so, while still leaving those who see no benefit in change to follow their previous methods. This is one of the areas where practices will probably change slowly rather than at a stroke of the Fourth Directive.

d'Illiers [1984] takes this view:

"It will certainly take a number of years before French accountants know how (and dare ...) to distinguish clearly between the non-economic part and the economic part of the depreciation and provisions, but the path has been well indicated."

Income statement: the Fourth Directive offers a choice of four income statement formats with choices between horizontal or verticalforms, and the presentation of expenses either by nature or by function. France has opted for expenses by nature, and the vertical format.

The new 'compte de resultat' (income statement) replaces two previous statements, the 'compte d'exploitation' and the 'compte des pertes et profits'. The 'compte d'exploitation' might very approximately be seen as a 'trading account' where sales, materials, labour and external supplies (such as power) were expensed, while the 'compte des pertes et profits' was used for interest, depreciation, prior year adjustments (differences arising from year-end estimations were separately identified and not allowed to fall into the next year's trading) and also transfers to and from reserves. The effect of the old presentation was to make any identification of the profit from continuing operations extremely difficult. The Accounting Decree requires (Art.16) that the new statement should permit the reader to see successively the operating result, the financial result, the current result before tax, and the exceptional result.

d'Illiers [1984] takes the view that although the new format will improve the value of the information, it will not achieve the object of enabling shareholders and creditors to gauge a result from continuing operations. He points out: "The text of the Directive includes an unfortunate ambiguity: the term 'exceptionnel' in the French version corresponds to the word 'extraordinary' in the English version". Exceptional items (in the spirit of the Directive) should be classified as part of the ordinary result but disclosed in the notes, whereas the French text does not make this distinction.

He concludes: "the chances of an amendment to the PCG and above all a change in the habits of French accountants within a short period are too slight for the users of accounts, shareholders bankers and others, to expect the income statement in itself to provide a current result which will be a good forecasting instrument".

Other changes: the other changes noted above (balance sheet groupings, account numbers, different forms of PCG) are not particularly important changes. The change in balance sheet groupings should lead to a position where the analyst can extract the net worth from a shareholder perspective more easily than before. Barbier [1984], for instance, comments that: "the balance sheet favours a clear view of uses and resources in its main structure and also in the content of the different classifications which are no longer 'dispersed'."

Overall, the provision of the image fidele is made the objective of the annual statements, but the image fidele is expected to be given in most cases by following the detailed rules and where these are deemed insufficient, then by making additional disclosures. Only in an exceptional case is a departure from the rules possible – albeit the idea that any departure from the rules is possible would be judged as a major innovation by French accountants. The innovations contained in the new rules are in themselves quite substantial, although in some cases there is flexibility in the way in which these can be applied and therefore the possibility that the effects of the change will be minimised. The way in which the accounts are presented is clearer – the net profit for the period is more easily ascertainable and not distorted by movements in and out of reserves, and the balance sheet is easier to analyse.

Reactions to Change

The strongest reactions to the changes of PCG82 concerned the indeterminate nature of the true and fair view, and also worries about how accounts could manage to be, all at the same time, true, fair, sincere and regular.

The French delegates to the Groupe d'Etudes published an opinion [1980]:

"The idea of true and fair view should be the subject of some explanation. Otherwise it will leave too great a degree of freedom in its application:

- the true and fair view and economic reality ?

- the true and fair view and prudence ?

This explanation could be made by the legislators (it is not a question of codifying the concept, but providing a framework within which the concept may be understood).

In the absence of a legal or administrative definition, clarification of the notion of true and fair view should be made by a recommendation of OECCA."

In the same vein, du Pontavice [1984], an eminent academic lawyer took the view that "Certainly the CNCC will have to define what true and fair view means to them" (in fact they have not done so).

Some edge was given to the question by an amendment to company law to provide penal sanctions for managements which failed to give a true and fair view. Viandier [1984] notes:

"The principle of the true and fair view is really the fundamental standard against which the other rules should be judged; if a legal rule produces perverse results the preparer of the accounts has the order not to apply it, a very strange order in our legalistic system: the law should only be applied if correct. One can already imagine the nightmares of the managers endowed with the responsibility of measuring the truth and fairness of the view given by their accounts and making exceptions from the law on their own responsibility if the circumstances require it. In companies this anxiety will be shared equally with the auditor who will naturally have to evaluate – and certify – this truth and fairness".

Not all commentators, though, saw true and fair as requiring a major conceptual jump. For example, Caudron [1984] took the view:

"Those who comment on the true and fair view are divided into two camps, leaving many combatants in the middle ground. Some consider that the true and fair view brings nothing new, others on the contrary proclaim it a revolution, without explaining too much either why or how; yet others, and we are inclined to share their view, think that the true and fair view is only a logical step in an evolution, the terminology being only a representation of the evolution of ideas and practices".

A particular aspect of the French adoption of true and fair was that the pre-existing qualities of regularite and sincerite were retained by the PCG and accountants wished to reconcile the separate notions. This could not be a particularly fruitful occupation in that both notions are exceedingly vague and in practice are given different characteristics by different people (for example Lefebvre [1986] gives three possible definitions of sincerite, as also does Pham [1984]).

A view of the position is set out by Gelard & Pham [1984]:

"If regularite can be defined without debate as conformity to the rules and as quite separate from the two other notions, it seems that sincerite should be quite near to the true and fair view, even though more subjective; sincerite (at least in one of its accepted forms) concerns the conviction of those who prepare the accounts, while the true and fair view is aimed at the reader and should be objectively verifiable and perceived as such."

Pirolli [1978], chairman of the technical committee of OECCA, commenting on the relationship of true and fair to regularite and sincerite said:

"This concept is much wider, with a richer content. It is not sufficient to tell the truth, it must also be expressed in the most suitable form. Financial statements must give the the best picture possible of the reality which they are describing, with loyalty and frankness."

Some writers have seen the image fidele as simply an extension of sincerite. For example, de Pontavice [1983] said that "it is just an excess of sincerity". de Kerviler [1983], on the other hand, says:

"The use of the words 'regulier' and 'sincere' ... removes all ambiguity as regards the concept of true and fair: the true and fair view can only be obtained by the use of accounts which are sincere and regulier. Thus regularite and sincerite ...are not at all redundant. They are necessary conditions to obtain true and fair accounts, the true and fair view is the object to be attained".

The Search for a Signified

The way in which the Fourth Directive was framed specifies that the objective of annual accounts is to give a true and fair view, but also that adherence to the requirements of the Fourth Directive would normally provide this. Although the Directive specifies some valuation rules and the principle of consistency, it sets disclosure standards rather than measurement standards, thereby leaving a wide degree of flexibility in interpretation.

It would have been quite possible for the French to adopt the true and fair view while not shifting their view of accounting, as Vitrolles [1982], a former President of the OECCA, makes clear:

"Our British cousins rightly claim the paternity of the true and fair view, without however being able to define this idea which has been built up over fifty years of experience. An innate idea say some, very subjective say others; in any event diametrically opposed to those of countries impregnated for centuries with Roman law. For this reason a number of states have simply decided that there is a true and fair view when the annual accounts are established in conformity with the national regulations in force. As the law is not identical in each country, what should one think of the true and fair views obtained and their comparability ?".

If true and fair means in acordance with generally accepted accounting principles, then there is an argument that French true and fair should be in accordance with French generally accepted accounting principles. France would by that definition have true and fair accounts, even though they might have little in common with British true and fair accounts. However, attempts were made both by the OECCA and in the literature to explore what true and fair implied and to create a signified for it. As noted above, individuals such as Betrand d'Illiers were also very active in explaining true and fair and must have had the effect of creating a French true and fair signified. The literature suggests that true and fair was taken up in France as meaning that accounts should provide a view of the company which was relevant to external users, and in particular shareholders.

The OECCA devoted its 1981 annual conference to a review of fundamental accounting principles, including a lengthy consideration of true and fair. The conference proceedings were subsequently published and constitute the OECCA's most comprehensive analysis of gaap currently available to their members, and are frequently cited as an authoritative guide. The section dealing with true and fair starts by considering what the British understand by true and fair, including quotations from Lafferty [1975] to the effect that "a company's accounts should give the user a view of its position which conforms with the company's own view of its position" and Flint's [1979] view that "the obligation to give a true and fair view is only comprehensible as a permanent principle whose translation in accounting terms varies and evolves over time".

The view taken at the conference was that the true and fair view represented a 'final test': "the notion of true and fair view appears as a final test permitting a judgment, through the medium of accounting principles, of the degree of significance of the annual documents for the reader of accounts".

This in turn raises the question of the identity of the reader of the accounts, and the uses to which the information is to be put: "Since the view can only be true and fair in relation to the interpretation which the user will make of it, one must know for whom the view is intended and moreover which aspects of reality it is important to translate truly and fairly" (OECCA [1981]). The readers identified by the OECCA were: shareholders, creditors, personnel and the State (detailed as INSEE – the statistical office – the Ministries of Industry and Labour, and of course the Fisc).

The question of the user has given difficulty as French accountants attempted to evolve their own meaning, to create a French signified. Caudron [1984] expresses the problem as follows: "The first question which springs to mind is if it is possible to have only one true and fair view, in some way ideal and generalised, or if it is not necessary to have several views as a function of the different recipients or users. One does not dress in the same way for both playing golf and going to a cocktail party". He argues that in practice it is the CNC as a forum for debate between all the interested parties which has in the end to arrive at a solution: "Regulation, by definition, searches for unity while information tends towards diversity. Regulated information will therefore, like accounting principles, be a compromise between diverse tendencies, diverse needs. This is the case with the notes to the accounts which are, without any doubt, the great innovation of the PCG82 at a practical level".

Bethoux and Burner [1981] analysed user needs in relation to the image fidele; they identified 6 different interest groups. First was the State as tax receiver, where the writers underline the necessity to disconnect the tax measurement considerations; second were shareholders, where a potential conflict was seen between existing shareholders and potential shareholders in the operation of the prudence principle; thirdly came bankers and other providers of finance, where the opinion was given that they normally obtained their information directly from the potential client but might not find this so necessary in future; fourth were the personnel who it was thought would benefit from the new information provided to the extent of having a clearer picture of the state of the company's affairs; fifth were 'co-contractors' – clients and suppliers, and sixth organisations for centralising economic data, such as INSEE and the Centrale des Bilans at the Banque de France which it was thought would find much useful data in the notes.

Matt and Mikol [1986] are doubtful about the utility of a compromise which attempts to satisfy all interests: "What common path could anyone find for the investor who wants to ascertain whether the enterprise has the capacity to generate long term profits, the creditor who is interested in immediate solvency, the Fisc which fears an artificial reduction of the profit measurement, the banker who is pre-occupied by the capacity of the company to repay its debt and the economic analyst who wants to measure types of activity ?"

Many opinions are expressed in the literature about true and fair in attempts to construct a meaning for it, but it seems established that within the French context it was accepted as providing a view of the company that was relevant to outside users of the accounts. The major innovation being that the preparer and auditor had not only to look inwards to the company and provide accounts which conformed to the law, but they had also to look outwards to be sure that the picture thus created was not misleading to outside users. True and fair provided the legal power to set aside the rules, but likely to be more relevant in practice was the requirement to provide additional disclosure in the notes.

Apart from the change in attitude inherent in the French interpretation of true and fair, there is also the important question of changes in the underlying accounting rules. These changes revolve around two issues: (a) disclosing the effects of tax-driven measurement and (b) new methods of presentation which make the annual statements easier to analyse.

The Fourth Directive requires that where asset valuation is determined by tax rules, then the extent to which this valuation differs from an economic valuation should be disclosed. The PCG82 goes beyond this in as far as it calls for the balance sheet to show only economic depreciation within the fixed assets disclosures and show the difference between the economic depreciation and the tax depreciation as a separate component of shareholders' equity. Also in the income statement the provision for depreciation charged within the main operating section should be based on economic depreciation, with the additional tax depreciation element shown in extraordinary items.

On the face of it this method, while not totally freeing the shareholder measurement from tax distortions, does provide the opportunity for those to be identified. The accounting should provide therefore better information. However, it remains a matter of attitudes as to whether individual preparers would take the trouble to distinguish between the two elements, or whether they might simply take the easy way out of deciding there was no material difference. A further question of attitude is a general one that accounts prepartion involves estimates and allocations in other areas than depreciation and these are not specifically addressed by the PCG82. A preparer trained in a tradition of minimising profits because the Fisc is the principal user of the measurement does not necessarily switch to maximising profits very easily.

As regards the presentation of the accounts, a major reform was the re-organisation of the income statement. Previously this had been presented as two statements, neither of which provided a clear indication of profits for the year, principally because transfers to and from reserves were included. The revised single statement goes some way to rectifying this situation. It provides an operating result and a financial result, both of which offer the possibility of clearer analysis, but at the cost of passing many of the old tax reserve adjustments through extraordinary items. The balance sheet was also re-organised, with the book value of shareholders' equity more easily ascertainable and disclosure of the detail of fixed assets. (The effect of these changes on measurement is discussed in the next chapter.)

Interest Groups

The theoretical starting point for this study is that any change in accounting regulation emerges from the interaction of competing interest groups, rather than a desire to fulfill some notional ideal. The literature is not necessarily the best means of assessing the reactions of interest groups who may have been affected by the outcome of the change, but it is of some value in reviewing reactions.

Tax-driven measurement had dominated French accounting increasingly in the period since 1945 and arguably the most important question is whether the Fisc had maintained its stranglehold despite the true and fair view. Given that the basic rule that the books and statements of account must reflect expenses charged for tax purposes has remained in place, it seems that the Fisc has largely retained its grip. The PCG82 has had to resort to a stratagem which offers a compromise: all tax expenses are included, but some are shown as extraordinary items. In some ways this can be seen as a typical standard-setting compromise which goes some way to meeting conflicting demands but satisfies no technical ideal.

The freeing of financial statements from the effects of tax also involves changes in attitude which will be harder to discern and will take longer to come about.

If the influence of the Fisc is still felt, has the shareholder obtained any benefit ? The Commission des Operations de Bourse in its 1983 annual report welcomed the changes: "until now the only requirements were that the accounts should be prepared according to certain rules; these rules had to do with the method of establishing the accounts and there was absolutely no obligation imposed as regards the pertinence of the picture of the enterprise which was given to the reader. Now the French law, in harmony with the Fourth Directive, requires that the accounts should give a view which does not deceive, within the framework of accounting conventions which everyone expects to observe. The accounts should permit the state of the company to be diagnosed."

D'Illiers took the view that tax penetration was not as important as the removal of flexibility of methods. He said [1981] : "I believe that observance of the principle of consistency and the requirement to provide explanations for any change of methods constitute very positive elements, as well as that of the true and fair view once it has been understood. It should result in a gain in the value of company accounts which will provide better information for shareholders". Going on to note that flexibility of method often gave a quite misleading picture, he used the example of a particular company (Chatillon-Commentry), saying that "the developments mentioned in the Directors' Report said that the 1975 financial year had been catastrophic, but the accounts did not show any loss". He also pointed out (interview 1987) that the Creusot-Loire company which went into liquidation in the early 1980s had nevertheless been able to show several years of break-even prior to that.

As regards the financial analysts, Hannoset and Meriaux [1981] take the view that the utility of financial reports to analysts would increase. In part this would come from a standardised presentation of company data which would save a considerable amount of time in enabling analysts to arrive at the figures they need easily. However, they regard it as a first outline of something which eventually would develop into measurements comparable on an international scale. As observed above, the position of the financial analyst towards more easily understandable information may be ambivalent since while the information is an input which the analyst needs, his function as an intermediary is diminished if the information is too accessible to the non-specialist.

Barbier [1984], an analyst from a bank perspective, was more optimistic: "On the basis of documents which can be used almost in their original form, and which have been made much more true as a result of the obligation now placed on management to provide a true and fair view, the analyst should also be more responsible for making a judgement and his intellectual efforts should become both more incisive and more diversified".

For the accounting profession the distancing of tax measurement rules and the increased emphasis on judgment offer possibilities of increasing their professional status. The tax penetration of accounting can be seen as a severe limitation on the cognitive base of the profession (in restricting the profession's freedom to evolve its cognitive base independently) and a block on the profession's control of its market. Any diminution of the tax role should therefore help the professional project of accountants – indeed one might argue that disconnection could widen the market by creating a further specialism within the profession, as in the Anglo Saxon accounting professions, for managing the interface between accounting and tax measurements.

The increased emphasis on judgement of the true and fair view can be seen as a reinforcing the professional market by enhancing professional mystique – only the professional can say certainly what is true and fair. This element though is double-edged for a profession which had previously been sustained by detailed rules – the extra status is obtained at a cost of taking risk, and the risk in a code-law environment is perhaps seen rather more strongly than in the less exact common law environment.

One would predict therefore that those within the profession who were keen to expand its role and status would welcome the changes, while those who were risk-averse would oppose them. The literature is not particularly helpful here in that those who publish tend to be the more active professionals, whereas the risk-averse could be those concerned with avoiding fresh activity.

The professional literature heavily supports the disconnection of tax measurement but is relatively silent on the question of new demands on professional judgement. A survey (Mikol, Stolowy & Boussard [1986]) found that 69% of the professional accountants interviewed thought that the introduction of the image fidele and the notes to the accounts were a gain.

Bethoux and Burner [1981] took the view that the new approach would increase the judgmental aspect of auditing – but that this was simply a natural evolution:

"It seems that this progress towards the true and fair view concept creates new control problems for the auditor, as much concerning the application of fundamental accounting principles as on the content of the notes to the accounts; added to the auditor's role in controlling the accuracy of the information used is that of controlling the principles used and that of exercising a judgemental role on the quality of the information given to the users of the annual accounts.

The new requirements asked of the auditor and this increasingly apparent evolution in the type of audit seem to be confirmed by the law; yet there is neither a breaking off, nor a revolution, but rather an evolution already taken up some years ago by the professionals and their clients and by the CNCC which through its publications and training intiatives has prepared its members for this important mutation."

The most significant area where the literature is silent is in the reactions of enterprises to the accounting changes. The silence is partly for institutional reasons: although a professional qualification requires a period of practical experience in an audit firm and leads to membership of OECCA, anyone who takes up employment within a company loses their membership. OECCA is exclusively representative of practitioners. There is no professional body for accountants in industry other than the Association des Directeurs de Comptabilite (APDC) which is more of an exclusive club for top industrial accountants.

Bellande (interview 1986) a member of the APDC and CNC explained that business pressures left little time for developing professional initiatives – the APDC preferred to leave these to OECCA and react to developments rather than initiate. The consequence of this is that there is no public forum in which the industrial accountants regularly put forward a view. Bellande suggests though, that for large enterprises the introduction of the image fidele came much too late to be of any real significance. Large companies working in the international arena had recognised their need for accounts which could be understood internationally and had started in the 1970's to issue consolidated accounts which were either based on US gaap or some independently selected collection of gaap and corresponded in presentation to the annual reports of Anglo-Saxon companies.

Gelard [1985] confirms that this was the case at Elf-Aquitaine and Manson [1984] says that Carrefour started preparing consolidated accounts in 1972. However, both Gelard and Blueth [1984] (Renault) said that they used the fact that the new PCG required a wholesale change in computer coding etc. to tie in a complete re-organisation and restructuring internally. So in this sense the PCG82 would have had side effects which were not foreseen. It should not be forgotten, though, that a high proportion of the implementation costs of the PCG82 would have fallen on business – all accounting records and internal accounting documentation would have had to be radically revised to take in the new ledger structure and codes. Computerised systems would have required new software as well as the set-up costs of transferring the data from the old system and training staff. In this context it seems odd that there is scarcely a reference to business implementation problems in the accounting literature.

As far as it is possible to judge the effects on the constellation of interests it appears that the results are mixed. The grip of the Fisc was lightened, but not removed. In some ways the method used to deal with the problem could be taken as making the accounts more obscure rather than less. For the professional accountant the gains are more obvious – the judgmental nature of the accounting function is enhanced as is its importance to the business community in providing economic information. The tax adjustments could be seen as adding to the esoteric nature of accounting as well, so the profession generally may have gained in status. The new accounts are also seen as more useful to shareholders with higher disclosure and greater consistency, thus providing the analyst community with better raw material.

Conclusion

The introduction of the image fidele into France can be seen as involving two linked but separate arguments, one a matter of semantics and the other a matter of power.

The semantic argument involves the export of the true and fair formula through the agency of the European Community into the French accounting environment. The French can be seen to be inevitably in some difficulty in assimilating a formula created in one environment into a different environment. The absence of formal definition is an obvious focus for debate. But the image fidele was introduced as part of a Europe-wide attempt to improve the information content of company reports, and there is much to suggest that the companies themselves and many of the interested parties had already taken on board this idea ahead of the legal process, so the debate was not 'real' in that arena.

Many companies published accounting information in excess of the Fourth Directive requirements, and the Commission des Operations de Bourse insisted on extra disclosures from listed companies ahead of changes in the PCG.

However, within the particular structure of French accounting there was a 'real' struggle between the Fisc and the profession for control of the cognitive base of the profession, and because much of the Fisc's power had been incorporated into the law, it was necessary for the law to be changed. While it was relatively easy for companies to publish two sets of accounting statements, accountants would have some difficulty in establishing the credibility of a cognitive base which accepted one set of accounting rules based on tax law and other legal constraints and quite different measurement rules for voluntary disclosures. Consequently while many interest groups would be pleased to see the law catching up with changes in the business community, it is probable that the accounting profession had the most to gain.

CHAPTER VII

The Impact on Annual Statements

This chapter reports the results of an empirical study whose objective was to observe whether the adoption of the PCG82 had any discernible impact on measurements in the reported financial statements of French public companies.

As reviewed in chapter VI, the PCG82 reflected the Fourth Directive requirement that the effects of tax-driven depreciation should be disclosed, and that various balance sheet categories should be re-classified. It also required that previous year comparative figures should be given, thereby providing an opportunity to observe the measurement effect of the change. The PCG82 was effective for financial years starting on or after 1st. January 1984, but statements for the first PCG82 year would include comparative figures for 1983 which had originally been published in the format required under PCG57. This empirical study set out to make certain basic comparisons between the 1983 results as first published and those provided as comparative figures to support the 1984 results.

The presentation of the empirical work in the chapter will proceed first with an analysis of the measurement effects which might be expected, followed by an explanation of the method of obtaining a sample of corporate reports and the nature of those reports and then a presentation of the data extracted from those reports and the conclusions which may be drawn from the data.

Expected measurement effects

While the Fourth Directive calls for standards of disclosure which were much higher than the PCG57, the effects of adoption of the directive on accounting measurement in France are not so clear. Scheid and Standish [forthcoming] identified three major elements of change in the PCG82: (i) the introduction of the true and fair view; (ii) the use of notes to the accounts to provide additional information; and (iii) reference to accounting principles to explain the accounting policies adopted by the company. All of these would probably lead more to changes in disclosure rather than changes in measurement.

The French accounting law and the Fourth Directive both expect that application of the true and fair view requirement would lead in the first instance to greater disclosure by companies (where they felt that the statutory information was potentially misleading) rather than derogation from the law, so both (i) and (ii) would be likely to lead to more disclosure rather than any change in measurement. However, in terms of observing French absorption of the notion of the true and fair view, there is some interest in noting whether any companies refer directly to the true and fair view in their 1984 corporate reports and whether any rely upon the true and fair override to diverge from the regulations.

The possible measurement effects of (iii) are difficult to discern. To the extent that reliance upon accounting principles leads to a more consistent measurement approach, then this would impact upon measurement. But one cannot predict in what way it might do so,

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The possible measurement effects of (iii) are difficult to discern. To the extent that reliance upon accounting principles leads to a more consistent measurement approach, then this would impact upon measurement. But one cannot predict in what way it might do so, and evidence would always be difficult to obtain from published data since analysis would have to be sited in comparisons between the measurements which were made and those which might have been made.

However, a major change in a measurement approach which can be seen was the Fourth Directive requirement to disclose the impact of tax regulation on accounting measurement. The Conseil National de la Comptabilite issued an opinion (no. 25) that this should be operationalised in the following way: the annual depreciation charge should be split between economic depreciation (expensed within the ordinary result) and any additional depreciation charged to maximise tax allowances (expensed within the extraordinary result). The corresponding balance sheet credits should appear as a deduction from fixed assets in the case of economic depreciation and as a separate item of equity (provisions reglementees) in the case of tax-driven depreciation.

Although the aggregate value of depreciation would not change (either in terms of the annual expense or the accumulated provisions), and one might argue that this is not a measurement change, the effect of the change in presentation in the balance sheet is to increase the reported value of depreciable assets and to increase the reported value of equity. Consequently the measurement approach for two important balance sheet components was changed. This change can be observed through a direct comparison of the 1983 figures. As discussed in Chapter VI though, the impact of this change in approach depends upon the willingness of preparers to make judgements about economic depreciation which they had not previously been called upon to do, and some observers such as d'Illiers [1984] are sceptical about the rate at which attitudes are likely to change.

The way in which the figures are presented within the annual financial statements was also changed. The previous French practice of splitting the operating results into two statements (compte d'exploitation and compte de pertes et profits) was ended with the introduction of a single profit and loss account (compte de resultat) and the balance sheet classifications were also changed to some extent. Neither of these changes was expected to have any measurement effect – for example de Kerviler [1979] provided a worked example (at the time when the draft PCG was published) which took a set of statements prepared under the PCG57 and re-worked them. The net profit after tax was the same in both cases, and there was no change in the value of total assets or total capital and liabilities in this worked example.

However, in a later article Kerviler [1982] analysed the changes in balance sheet presentation in more detail. She observed that under PCG57 the sole criterion which determined the classification of assets was liquidity, whereas under the PCG82 assets are split into fixed assets ("tangible and intangible items which are expected to serve over a period in the company's activity. They are not consumed on the first occasion they are used") and circulating assets. The split is first between these two base elements, and only after that on the basis of liquidity. Consequently some elements which had appeared as current assets under PCG57 might become fixed assets under PCG82 and vice-versa.

Another specific change to assets is that under PCG57 the costs of issuing share capital and certain other formation expenses were carried as a non-depreciating asset (frais d'etablissement) under intangible assets, whereas under PCG82 they become depreciable and are presented below current assets as part of a special category of prepaid or deferred expenses (charges a repartir sur plusieurs exercices). All of these changes would affect the internal structure of the asset side of the balance sheet, but would not affect total assets.

Total assets could in certain cases be affected by the Fourth Directive requirement that there should be no offset of related debit and credit items. Showing both debits and credits in full would increase the value of both sides of the balance sheet. In addition the PCG82 introduced a new treatment for losses arising on unsettled foreign currency items. Where a company has a foreign currency liability at balance sheet date it should be re-stated using the closing rate. Where this increases the liability, this gives rise to four accounting adjustments: (a) a provision for foreign exchange loss is made by debit to the profit and loss account and credit to the provisions section of the balance sheet; and separately (b) the balance sheet liability is increased and a corresponding entry is made to the assets side of the balance sheet representing the foreign exchange difference. The effect of using this method is again to increase both total assets and total equity and liabilities.

On the liabilities and equity side of the balance sheet in general the changes brought about by the PCG82 are changes of classification within that side of the balance sheet. The major change is a clear split between equity and non-equity. Profit for the period and government grants are both taken into the equity section of the balance sheet.

In terms of predicting the measurement effects of the introduction of the PCG82, one can identify the following elements as being likely to change:

(a) the value of depreciable assets should increase with the recognition of economic depreciation separately from tax-based additional depreciation, and this would give rise to a corresponding increase in equity;

(b) total assets should also increase both as a result of no longer offsetting related debit and credit items and through the introduction of foreign exchange differences.

For the purposes of this study the main interest is to observe whether the published accounts of companies exhibit these tendencies and whether, indeed, they refer to the true and fair view. Although it would not be expected that the impact of the changes would be the same in all sectors of the economy, there is no particular interest in trying to identify and quantify very narrowly the effects in different industries.

The decision as to whether or not a particular company chose to recognise the effects of tax depreciation in particular might be influenced by a large range of factors: for example the importance which the management attach to the annual report in general, whether the management believe that shareholders attach importance to the accounting figures, whether the company's auditors have a strong view on the subject, the expected impact on the company's balance sheet, the approach which a company expects its competitors to take and so on. The decision could potentially be influenced by so many factors which are not measurable, that in the context of the present inquiry it does not seem particularly fruitful to go beyond assessing what were the measurement effects without looking for industry trends and so on.

Even if it were more central to the study to do so, the technical problems of, for example, analysing the accounts of diversified companies, having accounts which are reliably based on the PCG82 only for the parent etc. would mean that the results would not be very reliable at a detailed level.

The Sample

The object of the exercise was to obtain data about the change in asset values and the value of equity as measured using the PCG57 and the PCG82. The choice of companies to use as a sample in order to meet this object was constrained by a number of factors:

(a) The re-statement of the 1983 figures as comparatives for the 1984 accounts was not compulsory (interview Scheid 1987) and therefore it seemed probable that smaller companies might be less inclined to undertake the exercise, so the sample should be drawn from larger companies.

(b) A number of the larger companies in France are subsidiaries of companies with an Anglo-Saxon tradition of accounting, such as Shell France or Hewlett Packard France and their accounting choices might be influenced by their different management environment.

(c) Since fixed assets are a focus it is appropriate to concentrate on companies which could be expected to have a substantial fixed asset base.

(d) The overall research study is concerned with the implementation of the Fourth Directive and this impacts only upon individual company accounts, not group accounts. The PCG82 was compulsory for parent company accounts (and for the accounts of individual companies within the group but these are generally not published) but not for group accounts. In fact quoted groups were required (by the Bourse) to produce consolidated accounts for 1984 and many groups in the sample based their group accounts on the PCG82 but the consolidation and valuation methodology is neither uniform nor certain to be in line with the PCG82 in every way so could not serve as a basis for this study. A consequence of this constraint is that all of the parent company accounts would include a substantial proportion of investments in subsidiaries as part of their assets and indeed some would have no tangible fixed assets at all.

Bearing in mind the above constraints it was decided to build up a collection of French corporate reports for 1983 and 1984 which (a) were selected from a list of the top 200 companies in France as published by 'Le Nouvel Economiste' in November 1985; (b) excluded any obvious subsidiaries of non-French companies (e.g. General Motors France, Française BASF, Mobil Oil Française, ICI France, Unilever France etc.); (c) concentrated on manufacturing companies; while accepting that (d) inevitably some of these would actually provide very little insight into changes in valuation of fixed assets because such assets were held in subsidiaries.

As regards the choice of activity, the listing (which ranked companies by turnover) also specified their principal activity which enabled a sample to be drawn up which excluded (i) oil and chemical companies on the basis that most of these had been excluded under criterion (b) as not being under French control; (ii) service industries, utilities, transport, construction, banks, insurance and financial companies generally as non-manufacturing. However, retailing groups were kept in the sample on the basis that they form a significant segment of activity (29 of the top 200 companies) and would provide a comparison with the manufacturing companies.

Letters were written to the companies asking for their accounts for 1983, 1984 and 1985 as sent to shareholders (this was done in early 1987 and it was felt prudent to stipulate 1985 as well as the earlier years in order not to draw attention to the specific research objective). The response to the letter was mixed: some companies did not reply at all, some sent accounts only for 1985 while some sent accounts translated into English. The English language accounts were regarded as unusable for the purposes of the research because of the risk that the accounts had been re-stated to US or other non-French gaap. As has been observed before many large companies (interviews Bellande 1986, Scheid 1987) produce accounts in US gaap for international public relations purposes and for the international capital markets. A follow-up letter was sent to companies providing English language accounts or less than the three years asked for, and this produced more French accounts, but also confirmation that in many cases companies no longer held stocks of 1983 or 1984 accounts.

After the eliminations on grounds of industry or affiliation, those arising from failure to supply the desired reports and a few where takeovers or re-organisations had taken place during 1984 and the original 1983 figures were not comparable with the re-stated figures, the original 200 companies had been reduced to 52. These consisted of 44 companies which might be described as broadly 'manufacturing' and including 15 whose activities were specifically food manufacturing and 8 companies from the retail sector (see Appendix I).

The manufacturing sector included two steel companies, Sacilor and Usinor, which were then eliminated from the sample. Both companies were 75% state-owned and represented a state accumulation of bankrupt steel companies and both were insolvent (from a British perspective) having negative equity. It was felt that the inclusion of negative equity within the figures dealing with changes in equity would distort the results since commercial companies must ordinarily have positive equity and also that the particular situation of these companies meant that they were probably subject to political and social constraints which did not apply in the rest of the sample.

Empirical data

The data taken from the published accounts fell into two main types: accounting data drawn from the balance sheets, and comments on accounting policies drawn from the notes to the accounts.

Of the 50 companies all but two provided complete accounts including notes, but the last two provided only photocopies of the financial statements. Of the 48 providing notes to the accounts 46 made specific reference to the adoption of PCG82 although the remaining two (Olida et Caby and Eternit) confirmed that their accounts complied with generally accepted accounting principles. 37 companies also stated that their 1983 figures had been re-worked to provide appropriate comparative figures. However, it is possible that the 're-working' may simply have involved re-presenting in the PCG82 format without making any retrospective adjustments to tax depreciation.

There is no reliable test which can be applied to distinguish between those who re-appraised their depreciation and those who did not, since the re-appraisal may have resulted in the judgment that the tax depreciation allowance was sufficiently close to the economic depreciation not to warrant an adjustment. However, 32 of the companies did change their 1983 tax depreciation, so data will be given which refers both to the full sample of 50 and the sub-set of 32 where a re-appraisal is certain. The existence or not of a note about the 1983 figures in the notes to the accounts is not thought to be an effective means of separating the companies since some companies which did change their 1983 tax depreciation made no mention of the 1983 comparatives in the notes.

The balance sheet data was drawn up in three areas: the accounting value of 'provisions reglementees' (the component of equity which relates to tax depreciation), the value of 'capitaux propres' (shareholders' equity) and the value of total assets.

Provisions reglementees and equity

The balance sheet category of provisions reglementees in the PCG82 includes not only the new element of tax driven depreciation on fixed assets but also tax allowances which had appeared as part of equity under PCG57 such as an allowance for inflationary stock increases and an allowance for holding debtor accounts in foreign currencies. Consequently in comparing the two versions of the 1983 balance sheet it is necessary to compute the value of provisions reglementees which derives from these pre-existing provisions and compare this with the total provisions reglementees figure in the PCG82 version to obtain a measure of the adjustment which derives from a re-allocation of fixed asset depreciation.

The components of 'capitaux propres' under PCG82 include both the result for the year and government grants and for the purposes of the comparisons below the PCG57 equity figure was re-computed for each company to include these items.

	Non-food Manufactrg	Food	Retail	Total
Full sample				
N =	**27**	**15**	**8**	**50**
Inc in PR	F543.5m	F32.9m	F103.3m	F679.7m
Inc in Equity	F537.5m	F35.8m	F103.3m	F676.5m
PR as % of Equity	8.66%	5.96%	14.03%	8.77%
Increase in PR as				
% of equity	1.41%	0.34%	1.72%	1.25%
Change in equity	1.40%	0.37%	1.72%	1.25%
Inc in PR as				
% of PR	16.31%	5.66%	12.27%	14.29%
Sub-set				
N =	**19**	**7**	**6**	**32**
Inc in PR	F543.5m	F32.9m	F103.3m	F679.7m
Inc in equity	F537.5m	F32.9m	F103.3m	F673.6m
PR as % of equity	9.45%	6.80%	16.11%	9.96%
Inc in PR as				
% of equity	1.98%	0.59%	2.00%	1.78%
Change in equity	1.96%	0.59%	2.00%	1.76%
Inc in PR as				
% of PR	20.95%	8.70%	12.42%	17.87%

(Table 7.1)

Assets

As discussed above, a number of changes of asset classifications took place between PCG57 and PCG82 and as a consequence it is not possible, on the basis of published accounts, to make a direct comparison between tangible fixed assets under the PCG82 presentation and those under the PCG57 presentation: comparisons can be made only in terms of total assets.

Although the application of the foreign currency rules and the Fourth Directive rule of not off-setting items would lead to an expectation that total assets would increase under the new presentation, even if companies did not recognise tax-driven depreciation, 6 companies actually showed a decrease in total assets, while 9 showed no change and 35 recorded an increase in assets. The range of change was from -1.16% to +6.37%, the average was +1.47%.

The worst decrease in assets was suffered by Carrefour, whose balance sheet total fell by F72m, despite recognising an extra F74m in provisions reglemntees. The company provided a detailed note on the reclassification of its 1983 accounts including the information that F180m of payments on accounts of corporation tax which had been shown as working capital in the PCG57 presentation had been offset against liabilities in the PCG82 presentation – the opposite of what might have been predicted. DMC suffered a decrease of F10.9m or 0.6% of total assets but made no comment in its notes. Generale Biscuit lost F893,494 (0.1%) and its notes said that the only change was presentational, Roussel Uclaf lost F3,909,732 and also specified that the change in PCG 'has no effect on the 1983 accounts'. Au Printemps showed assets reduced by F1,581900 after recognising an addition F1,587,452 in tax depreciation; it drew attention to this in the notes but said it was as a result of reclassification between assets and liabilities.

	Non-food Manufactrg	**Food**	**Retail**	**Total**
Full sample				
N =	**27**	**15**	**8**	**50**
Inc in assets	1.78%	1.20%	0.33%	1.55%
PR inc as				
% of assets	0.39%	0.20%	0.48%	0.38%
Tangibles as				
% of total	8.43%	9.76%	16.94%	9.59%
PR inc as				
% of tangibles	4.65%	2.00%	2.83%	4.00%
Sub-set				
N =	**19**	**7**	**6**	**32**
Inc in assets	1.96%	1.83%	0.35%	1.74%
PR inc as				
% of assets	0.45%	0.39%	0.53%	0.46%
Tangibles as				
% of total	8.92%	8.73%	18.43%	10.16%
PR inc as				
% of tangibles	5.09%	4.49%	2.88%	4.53%

(Table 7.2)

Relative size of companies

In view of the general proposition stated above that larger companies would be more likely to reappraise the 1983 accounts than smaller ones, a simple size test was also carried out by calculating the mean of each sub-set, using total assets and total equity as indicators of size. It can be seen that in all cases the sub-set recognising additional provisions reglementees were on average larger companies. A second point emerged from this that, using the ratio of equity to total assets as a form of inverse gearing ratio, it can be seen that on average the companies recognising tax depreciation were more highly geared (except in the food sector) than those not recognising it.

	Non-food Manufactrg	Food	Retail	Total
	Full Sample			
Mean total assets	F5137.5m	F1121.0m	F2691.8m	F3541.2m
Mean equity	F1426.1m	F649.9m	F749.9m	F1085.0m
Equity/asset ratio	27.8%	58.0%	27.9%	30.6%
	Sub-set			
Mean total assets	F6298.7m	F1197.6m	F3244.4m	F4610.2m
Mean equity	F1445.3m	F793.6m	F860.0m	F1193.0m
Equity/asset ratio	22.9%	66.3%	26.5%	25.9%

(Table 7.3)

Notes to the accounts

Of the sample of 50 companies, 2 did not provide notes to the accounts, having sent in photocopies of the financial statements in the absence of a printed report; the percentages given refer to a sample therefore of 48. The PCG82 calls for the disclosure of accounting policies in the notes to the accounts. All the companies gave details of their methods under the headings of tangible assets, investments and so on, but not all drew the shareholders' attention to the fact of the change in accounting regulations and commented on the effects of the new approach.

Of this sample 46 referred to the PCG82 and 37 (77%) drew attention to the re-working of the 1983 figures. 17 companies (35%) then went on to specify that there had been no change in valuation methods (although 9 of these had demonstrably re-appraised their depreciation) with 12 of these remarking that the impact of the PCG82 was purely presentational. 7 companies (15%) referred to the requirement to separate economic depreciation from tax depreciation and 3 companies also referred to the new method of dealing with unsettled foreign exchange items. 5 companies (Moet-Hennessy, Carrefour, Au Printemps, TRT and Roussel Uclaf) provided detailed notes about the re-working of their 1983 figures; it may or may not be significant that 3 of these are amongst the 6 companies which registered a decrease in total assets.

Two companies, Thomson and Financiere Strafor, referred to the image fidele in their reports. Thomson took the view that the 'ordinary' result as required by the PCG82 did not provide a proper economic result, and advised shareholders to look to the result after extraordinary items. Strafor took the view that the PCG82 profit and loss result was inappropriate for a holding company and chose to present its results in a different way, relying upon the true and fair view.

Conclusion

In terms of the overall objective, to observe whether or not there was any increase in total assets and any increase in equity, the evidence of the sample shows that 70% of the companies did show increases in assets and 64% did register an increase in equity. The implication is that, in terms at least of how the balance sheet was presented to the shareholder, the accounting measurement of the company was changed by the PCG82, and at least two-thirds of the companies took the Fourth Directive view of tax distortions sufficiently seriously to rework accumulated depreciation in the 1983 accounts, resulting in an increase in net tangible assets and in equity. Those companies which changed their depreciation recorded an average 4.5% increase in net tangible assets and a 1.76% increase in the value of equity. Total assets increased by 1.74%.

The figures show that the effects of adoption of the Fourth Directive were different in different sectors. The retail sample showed a 2% increase in equity but only a 0.33% increase in total assets and a 2.83% increase in tangible assets. Food manufacturers showed a 0.59% increase in equity against 1.98% for other manufacturers in the sample and 2.0% for retail companies.

It may be, though, that the size is also a factor in that using the mean total assets and mean equity of each group as a size indicator, those companies recognizing tax depreciation were in all sectors larger than the average. Also looking at relative size between sectors, the mean non-food manufacturing company was larger than the mean retail company, while the mean food manufacturer was the smallest in size as well as recording the lowest average increase in equity. The tests conducted by Watts and Zimmerman [1978] suggested that firm size was a factor influencing management attitudes to financial standards in the United States.

In as far as the change in treatment of depreciation can be seen as the main measurement change in French accounting arising out of adoption of the Fourth Directive, and also as an important difference between the approach of the previous sincere and regular accounts and that of the true and fair view, the empirical evidence of this sample is that at least 64% of companies were prepared to recognise a difference between economic depreciation and tax depreciation in their 1983 figures. There is also some implication that larger companies are more likely to recognise this, so that in terms of economic activity, companies adopting the new approach might cover more than 64% of the activity of the sector.

Chapter VIII

Empirical Study – Comparing the True and Fair View in France and Britain

The final component of this research involved empirical work whose objective was to attempt to observe whether there was a consensus in each country as to the operationalisation of the true and fair view and also whether this was substantially different between France and Britain.

If one takes the view, as discussed in chapter two, that the true and fair view is a code expression for generally accepted accounting principles as applied by experienced practitioners, then one way to make a comparison between countries is to obtain an example of the application of generally accepted accounting principles by such practitioners.

This approach would, for example, accord with the implications of the legal opinion obtained by the ASC [1983]. This is that, outwith any new legal definition or case law, generally accepted accounting practice would constitute a true and fair view, and that exactly what constitutes generally accepted practice can only be determined by obtaining a consensus from practitioners. It would follow that if there is general agreement amongst accountants this would be evident when a number of accountants prepare statements from the same data, and to the extent that there is agreement, one might discern what was held to be a true and fair view of that data.

Applying this approach to the true and fair view and extending it to France, if there were a reasonable consensus amongst French accountants in relation to some data, then here too one may see how the true and fair view is operationalised in the French jurisdiction, and have a basis for comparison between the two countries.

A secondary point here, not essential to the true and fair study, is the extent to which the application of standards leads to uniform measurements. The ASC [1981] maintains that the main aims of standards are to "narrow the choice of accounting treatment so that financial statements are written in a common language which is clearly understood and also to seek to make financial statements reasonably comparable one with another".

This secondary point is of interest in relation to France since the conventional wisdom of the international accounting world is that "it is generally believed that French financial statements are prepared in a much more standardised manner than the British" (Nobes and Parker [1985]). Nobes [1984] classifies France in his 'macro-uniform' group while putting Britain in the 'micro-based, pragmatic' section. There is therefore some interest in seeing whether in the empirical research the French element produces results which are more uniform or less uniform than the British.

At the same time, though, it is necessary to bear in mind that the Fourth Directive prescribes certain disclosures and certain valuation rules which should lead to uniformity in those areas. The more useful comparisons are likely to be in the areas not covered by the Fourth Directive specifically (although embraced by the true and fair view) such as measurement issues. Critics of the harmonisation process (Burgraaff [1983], Busse van Colbe [1983], Choi and Bavishi [1983] etc.) all point to different approaches to measurement, springing from different perceptions of the functions of the measurement and attitudes to conservatism, as greater obstacles to harmonised reporting than simple disclosure.

This chapter will present the results of empirical work which involved obtaining sets of financial statements from both British and French accountants which had been prepared from common source data. This will be presented first by exploring the methodology, then reviewing predicted outcomes, presenting an accounting analysis of the results and finally a brief statistical analysis.

Methodology of empirical study

The objective of testing for a consensus of best practice poses a number of problems in obtaining information which covers a sufficiently wide area of accounting measurement, and which is given on a basis which may be relied upon.

A theoretical ideal would be to compare actual accounts published by companies in both countries to see what accounting decisions had been made. This approach is, however, fraught with practical limitations. In the first place it is necessary to find companies which are comparable, and in the second place to be able to work out from their published results what accounting decisions have been made or obtain answers directly by interviewing the preparers.

It is next to impossible to find companies which could be used since most large companies have diversified activities, while insufficient information is generally available to enable one to identify small companies which are directly comparable. Even were one able to identify such companies it is unlikely that they would be willing to disclose details of their accounting measurements for ultimate publication.

There are two existing major empirical studies which have set out to identify transnational measurement differences (Davidson & Kohlmeier [1966] and Gray [1980]) as opposed to those which have examined disclosure differences, such as Choi [1973], Barrett [1975]). The measurement studies have attempted to resolve the practical problems in different ways. Gray [1980] based his study on published financial data and attempted to evaluate the degree of conservatism between British, French and German measurements. His method was to compare the reported profits with an adjusted profits measurement calculated using a method standardised by the European Federation of Financial Analysts Societies (EFFAS).

As Gray points out, the EFFAS adjustments are made without any knowledge of the underlying data and 'can only remove the impact of some of the more obvious differences in accounting treatment and are thus likely to provide a somewhat modest assessment of the full position'. But the EFFAS method 'does provide a common yardstick, for comparative purposes, which is perceived to be of significance to security analysts in the process of making investment decisions'.

Another disadvantage is that the EFFAS method may be seen simply to replicate any bias which is built into the European analysts' system: for example the standard adjustments generally involve removing 'any provisions which are of a purely expectational nature or which are designed mainly to obtain short term tax advantages'. One might therefore expect that generally the EFFAS method would produce higher profits than those reported where such tax manipulation is commonplace, as in France and Germany at that time.

The alternative to using published data is to formulate some type of simulation and one example of this approach was carried out by Davidson and Kohlmeier [1966] and extended by Abel [1969]. The original study was a computer simulation of the results which would have been reported by two US companies had their accounts been prepared according to British, French, Dutch or Swedish gaap, while Abel extended the process to include Germany. The experiment involved ascertaining, by means of interviews and library research, the 'best practice' in each of the jurisdictions concerned as related to the accounting decisions in the model. This 'best practice' was then built into the computer to provide five years' results for each company according to each set of gaap, enabling an analysis to be made of the resulting measurements.

The disadvantage of this approach, as with Gray's method, is that it relies on building in a set of adjustments and the effect of these is then systematically to provide a different result. The research evidence is in the construction of the adjustment while the empirical results are simply illustrative of the adjustment. The adjustment was in fact constructed by Davidson and Kohlmeier and involved making decisions about which practices to adopt: "the answers from respondents within a country were sometimes contradictory. It became clear that accounting procedures within a country were rarely uniform; thus the procedures specified here are those which, in our judgment, are most commonly used within each country". Inevitably the methodology excluded any possibility of measuring variability of accounting practice.

Both Gray's approach and that of Davidson and Kohlmeier depend upon a single uniform approach to gaap and do not therefore offer the possibility of observing variability within each jurisdiction and will produce results which replicate the prior judgments involved in constructing the model. Consequently an empirical experiment was devised which might allow a more observable reaction from accountants within the two countries. The approach consisted basically of presenting accountants in each country with data about a hypothetical company's transactions and asking them to prepare financial statements in accordance with domestic gaap which reflected those transactions.This method involves a series of problems in preparing the initial data, finding respondents and obtaining a usable result.

A major disadvantage is that respondents are aware that the data is artificial and that there is no practical outcome from the accounting decisions taken: therefore there is a risk that the results produced will not be those which would have been produced under real life conditions. However there is a major advantage of using artificial data in that all respondents can be faced with precisely the same decisions and therefore the outcomes can be compared directly and the decisions analysed in detail. There is, though, a limitation that the example chosen will be drawn from a particular industry and will fail to pick up any industry biases.

The method of obtaining a response from accountants in respect of the accounting decisions posed involves a choice between a widespread questionnaire approach and a narrow in-depth study. The questionnaire allows the use of a much larger sample, but involves restricting the questions posed to those which might be answered in a reasonable amount of time – perhaps less than half an hour. The validity of the questionnaire depends upon a sufficient number of people being prepared to respond to it and does not permit of any interaction between researcher and respondent, so if the questions are not apposite or the respondent misunderstands them, the survey may be useless. The questionnaire has also fallen into some disrepute partly as a result of these operational difficulties and partly because there is evidence which suggests that respondents tend to give the answers they believe are expected.

By contrast an in-depth survey offers the possibility of posing more searching questions and allowing follow-up if necessary. However, it is very difficult to disguise the objective of the survey and there is the risk of biased answers, although this may be diminished to the extent that the respondent can be specifically identified and knows that he may be asked to explain a choice. A particular problem in evaluation is that the sample will be very small, therefore not necessarily representative and not statistically significant.

In this case it was decided to pursue an in-depth, artificial case study with a very limited number of respondents. The main argument in favour is that this approach allowed the study to include a relatively complex set of accounting decisions which covered a wide range, but that as these are all integrated within the same case, they can be seen to relate to each other and the preparer has available a body of material which gives him a better picture of the artificial entities – hopefully the incidence of the artificiality is reduced.

A second aspect is the importance of being able to ensure that respondents are both willing to deal with the case study and also to take it seriously. This is particularly difficult in a cross-cultural environment and it was believed that a questionnaire approach might have received a very poor response rate (why should French accountants respond to a questionnaire from a British academic ?). A major problem also is that accountants are understandably somewhat shy of preparing accounts which can then be compared with other accounts produced elsewhere. They need to have confidence that their goodwill in participating will not be abused. The in-depth study made it possible to approach individuals directly or through their professional bodies with a relatively good chance of them responding seriously.

The sample could not be chosen at random, or indeed in a statistically representative way because of the inherent difficulties in obtaining any response at all. The target was a sample of 60 accountants: 30 in each country, split 10 from capital city practices, 10 from provincial practices and 10 from large companies. The rationale for this was that although one could not select respondents individually, it was worth having a sample which included both accountants who work for a commercial company and those in a practice, and that it was worth making some attempt to measure whether attitudes were any different away from the capital city. The target of 60 is high for an in-depth study but was set in the hope of achieving at least 30 responses within the time limits of the exercise (in the event this minimum target was just achieved).

The individuals who constituted the target were approached in the following ways. In France the Paris practitioners were approached by the Conseil Superieur of the Ordre des Experts Comptables, while the provincial practitioners were contacted by the Conseil Regional in Angers and help was also given by the Ecole Superieure des Sciences Commerciales d'Angers (ESSCA). Accountants in multinationals were contacted directly by the researcher on the basis of advice and introductions from the Association des Directeurs de Comptabilite. In England, individual partners (either known to the researcher, or otherwise the senior partner) of London practices were contacted directly, as were finance directors etc. of multinationals. The provincial sample was obtained with the help of the Northern Society of Chartered Accountants, who circulated the request among their Newcastle members.

Design of the case study

In designing the actual case study to be submitted to the sample, it was necessary to strike a balance between areas where accounting regulations in the two countries are known to be different on the one hand, and accounting areas where the same choices are available in both countries on the other. The first set of decisions needs to be incorporated in order not to gloss over well-established differences which must carry over into true and fair (such as tax-oriented depreciation, or treatment of leased assets). The second set is required to test whether, given the same choice there is any noticeable pattern in final decisions made. At the same time it was necessary to select choices which, as far as possible, were not inter-dependent.

The final selection of items for consideration in the case study was made in the following way. Firstly, a list of issues in financial accounting (from a British perspective) was created, using textbooks as a measure of what are regarded as the more contentious issues within conventional historical cost accounting. For example, Lewis, Pendrill & Simon [1981] cover in their last two chapters on 'Further problems of accounting measurement':

- fixed assets: determination of cost, depreciation;
- treatment of government grants;
- accounting for leases;
- intangible assets;
- stocks and work in progress;
- pensions;
- taxation: imputation system, deferred taxation;
- post-balance sheet events;
- contingencies;
- extraordinary items & prior year adjustments.

Other items which are relevant to the international field are:

- treatment of items denominated in foreign currencies;

- translation of foreign subsidiaries.

This list was then compared with known or accepted areas of difference between France and Britain, drawn from the literature on the subject such as Bussac [1984] and then finally the issues were discussed with representatives of the OECCA and the APDC. From this process the following items were selected:

Areas where both countries have choices

- fixed assets: determination of cost, depreciation;

- treatment of government grants;

- stocks and work in progress;

...but not necessarily the same choices

- extraordinary items;

- treatment of items denominated in foreign currencies;

- translation of foreign subsidiaries.

Areas where practices are known to be different

- leased assets;

- deferred taxation

As regards the issues not pursued it was felt that these either would not add any particular dimension because the differences are well documented (intangibles) or incorporation into the case study would be so far removed from the rest of the study as to be undesirable (pensions etc.).

The focus of the study is a construction company which during the year under review starts up an overseas subsidiary to carry out a long term contract. Participants were asked to prepare an income statement and balance sheet for (a) the overseas subsidiary (b) the parent company and (c) the group. The exchange rates and transaction data were provided in exactly the same way to both French and British participants, except that parent company data was expressed in Francs or Sterling as appropriate on the basis that FF10 = £1.

(a) the overseas subsidiary

The main accounting decision here concerns the treatment of a long term contract: firstly whether or not any profit should be taken on the contract, then on the treatment of work in progress and the payments received from the client. Additional issues were payments (in head office currency) for management services and the use of leased plant.

(b) the parent company

There are a number of decisions within this area. The company faced a compulsory purchase of its premises giving rise to a loss (should this be an extraordinary item ?), it built new premises which were in part financed by a US Dollar loan (possible capitalisation of interest, treatment of exchange difference at year end). It arranged the sale and leaseback of some plant with a possible disposal profit arising.

(c) the group

Given that the Fourth Directive does not apply to group accounts, it was not necessary to include the group figures in the exercise. However, there is very little further work involved in this particular case, so it seemed worthwhile including it, and to British eyes the case would seem odd without a group accounts requirement. It also offered the opportunity of including the translation methodology in the case study.

Predicted outcomes

Both Busse van Colbe [1983] and Burgraaf [1983] draw attention to the difference in perceptions of the purposes of accounting statements in different countries within the European Community and claim that even if some degree of harmonisation is achieved by the company law directives, underlying attitudes to measurement will remain different.

The analysis of French accounting since 1945 which was carried out in chapter four shows that measurement has been dominated by tax considerations and therefore profit minimisation. The more conservative measurement is confirmed by both the Davidson and Kohlmeier and the Gray studies.

The Davidson and Kohlmeier study expressed results of two US corporations after re-statement into foreign gaap. The results as they relate to UK and French gaap and expressed as a percentage of the US gaap result are:

	1960	1961	1962	1963	1964	Mean
Net income before taxes						
SteelPro:						
France	94	96	98	102	101	98.2
United Kingdom	101	110	108	111	107	107.4
ElPro:						
France	93	87	81	87	92	88.0
United Kingdom	99	99	98	99	99	98.8

(Table 8.1)

It is interesting to note that while the relationship between the French and British measurement remains similar for both companies (chosen to represent an old industry and a new one), their joint relationship to the US measurement varies with the industry.

Gray constructed an 'Index of Conservatism' which measured the relationship between reported profits and profits after adjustment using the EFFAS method. Where the two figures were exactly equal this gave an index of 1. Grey classified his sample into 'pessimistic' (index < 0.95), 'neutral' (index 0.95-1.05) and 'optimistic' (index > 1.05). The results for the UK and France were:

	Pessimistic		**Neutral**		**Optimistic**	
	No.	**%**	**No.**	**%**	**No.**	**%**
France	46	77	5	8	9	15
United Kingdom	17	14	32	28	67	58

(Table 8.2)

Although there are reservations about the methods used, the results in both cases support the expectation that measurement in France would be more conservative than in Britain.

The analysis of pressures which may influence accounting in France in chapter four provides evidence that from the mid-sixties there was a movement away from a tax orientation. However this could only manifest itself initially through the publication by some companies of secondary annual reports using foreign or hybrid gaap. This pressure may have made acceptance of the Fourth Directive easier, but it remains open to question whether attitudes at the operational level would change very quickly. d'Illiers [1984] observed: "the chances of ... a change in the habits of French accountants within a short period are too slight for the users of accounts, shareholders, bankers and others, to expect the income statement in itself to provide a current result which will be a good forecasting instrument".

In general one would expect that the French true and fair view would provide a more conservative measure of profit than the British, even after implementation of the Fourth Directive.The question of uniformity of measurement within a jurisdiction has not been widely explored, although Nobes and Parker [1985] suggest that French accounting measurements would be more uniform than British. British accountants such as Benson [1973] have laid claim to a tradition of accountants exercising a high degree of individual judgement which might be presumed to lead to less uniformity.

Analysis of Results

The results have been analysed in two ways. In the first instance they are analysed from the perspective of accounting technique in the form in which they were submitted. However, a second analysis is done from a statistical viewpoint and in this the results have been adjusted to remove tax differences and exchange differences in order to permit more direct comparisons for statistical purposes.

The response to the case study consists of three related sets of financial statements, and these are also to be analysed in three ways: British true and fair view, French true and fair view, and a comparison of the British and French results. This creates a matrix of analysis and in setting out the details one could proceed either by starting from each set of statements and examining the set from the three perspectives, or by starting from the perspective and examining all three sets of statements in relation to the individual perspective.

It seems more fruitful to set out the analysis by concentrating on the true and fair view in relation to each set of statements and this follows, starting with the overseas subsidiary, then the parent company and finally the consolidated statements.

30 responses were received in all: 15 from French respondents and 15 from British. Each set of responses contained at least three from each sub-set (capital city practice/provincial practice/multinational) but some sub-sets are so small that it is difficult to draw any statistically valid inference about differences between sub-sets,

though this will be reviewed in a later section. The actual responses received to the case study fell into the following categories:

	Practice Capital	**Practice Provinces**	**Corporate Preparer**	**Total**
France	7	5	3	15
Britain	6	6	3	15

(Table 8.3)

The Overseas Subsidiary

The chief measurement issue in this section is the treatment of a long term contract, while secondary issues are the treatment of a leased asset and presentation of the relevant costs and balance sheet items.

For the long term contract, the study made it clear that the expected profit was equal to 25% of costs and gave details of both costs incurred during the period and payments on account received from the client. The range of possible responses would be at one extreme to treat all costs as period expense and recognise no revenue, or at the other extreme to recognise 'turnover' sufficient to include 25% profit on costs to date. Intermediate courses would be to allow costs and revenues to flow through the income statement, but not to recognise any profit, or to capitalise costs as work in progress. Within these areas of choice there are also questions as to whether interest paid should be treated as a period financial expense or as part of the direct costs of the contract, and whether the costs passed on from the parent were eligible for capitalisation as part of the long term contract cost. Where the leased plant is capitalised the respondent had to make a decision not only about bank interest but also about the lease interest.

The subsidiary works entirely with leased assets, both premises and plant. It would be expected that the British approach would be to capitalise the leased plant while the French would not. The expected effect would be for the UK respondents to have more assets and liabilities in the balance sheet, and for the income statement to show depreciation and interest instead of lease rentals.

True and Fair View

SSAP 9 says that 'where the business carries out contracts and it is considered that their outcome can be assessed with reasonable certainty before their conclusion, then the attributable profit should be taken up, but the judgement involved should be exercised with prudence'. Work in progress should be stated at cost plus attributable profit less any progress payments received and receivable. No particular method of calculating "attributable profit" is specified. Cost, according to the guidance notes, may include interest where the finance can be related specifically to the contract.

The treatment of long term contracts was in fact under review by the Accounting Standards Commmittee during the period when the case study was being circulated. The main reason for this was that the Department of Trade and Industry took the view that the inclusion of unrealised profit in work in progress was a contravention of the 1985 Companies Act requirement that "the amount to be included in respect of any current asset shall be its purchase price or production cost". Companies were observing SSAP 9 and relying on the true and fair over-ride in relation to the Companies Act. (Pawson [1987]).

A further problem identified by Pawson is: "SSAP 9 does not address how contract sales revenue and related costs should be recorded in the P&L account. In practice a variety of methods has been used to determine the turnover disclosed in each accounting period. However,in many cases, this has not been derived from a formal integration of revenue, cost and balance sheet accounting".

The British requirement on leases (SSAP21) is for the lessee to capitalise leased assets where he enjoys substantially all the risks and rewards of ownership. The premises lease would not qualify for capitalisation, but the plant is specified as being used for effectively all its working life. UK respondents would therefore be expected to capitalise. The case gives the deemed interest rate for the leasing transaction so no calculation was required.

The UK respondents were far from unanimous in their view of the treatment of the long term contract, although they exhibited much greater unanimity in the balance sheet treatment than in the profit and loss account, which latter reflected the variety cited by Pawson. 4 respondents took a profit, 4 recorded neither a profit nor a loss and 7 recorded a loss on the first six months of the Kuwait contract. 3 respondents did not record any turnover, including one who made no profit and loss account entry at all.

The 4 profit-taking respondents showed some variety in their computation of profit: pre-tax profit varied between KD22,600 and KD46,983, with the differences relating to differing turnover figures rather than different costs, and springing therefore from different views about "attributable profit" computations.

The 7 loss-recognising respondents had a wider dispersion of results, between KD5,000 and KD156,095, although the higher loss figure may well be the result of a computational error and the intended result should in that case have been a loss of KD26,095. The highest loss recorded otherwise was KD81,082. For these respondents the base position is not to recognise any unrealised profit, and the differences arise out of different decisions as to what costs should be capitalised and carried forward, and what treated as a period expense.

The choice of expenses in this connection was not consistent between respondents. For example the KD13,024 loss consisted entirely of interest deemed to have been paid on the lease and bank interest, whereas the KD81,082 loss included bank interest but lease interest was capitalised. The combination of some respondents taking profit, some not and different respondents capitalising different costs also resulted in widely different turnover figures. Three respondents recorded no turnover in the profit and loss account, the remaining twelve recorded figures varying from KD37,192 to KD 234,914.

The balance sheets of the Kuwaiti subsidiary varied much less. Only one respondent did not capitalise the leased asset, although one respondent chose to treat it as a component of work in progress.

However, the differing solutions of profit and loss account questions automatically carry through to the measurement of work in progress, while the different profit or loss results similarly affected net worth.

Evidently it is not easily possible from this sample to determine a clear concensus view of the Kuwait contract, although the simple profit or loss result obscures the position by bringing in the separate issue of deciding which costs to capitalise and which (if any) to treat as a period expense. The underlying position is two problems:

(1) to take profit or not: 27% (4 respondents)in favour, 73% (11 respondents) against,

(2) to capitalise all Kuwait costs or not: 53% (8) in favour, 47% (7) against.

The fact that the two groups are not the same gives us the situation where there is not even a simple majority for any solution: 4 show a profit, 4 capitalise all costs and 7 show a loss. To the user without access to the underlying workings, the range of results on the Kuwait subsidiary would seem difficult to understand.

Image Fidele

The PCG82 (p224) allows that profits on long term contracts may be taken either at the conclusion of the contract or during the course of the contract. Where an interim profit is recognised, the recommended method of computation is to use a proportion of final profit based on the proportion of costs already incurred to budgeted total cost (this is somtimes referred to as the 'percentage of completion' method).

The company (and the auditors) must be satisfied that payment is certain and that the client is satisfied with work to date. The unrealised profit is not added to work in progress but appears separately in the balance sheet in a form of suspense account (compte de regularisation). Interest costs may be included in work in progress, but are taken as a period expense for tax purposes.

The PCG82 (p218) does not allow capitalisation of leased assets except where a purchase option has been exercised – i.e. only when title has passed. Lease rentals are treated as operating expenses. Obligations for future lease payments should be disclosed in the notes, and the PCG recommends that for fixed assets these future obligations should be discounted.

The respondents were divided more than 2 to 1 against recognising an unrealised profit on the long term contract, but the majority who did not take a profit were not uniform in their treatment or result. 4 respondents recognised a profit and their actual figures were all computed on the same base (percentage of completion) and came out very close. However, of the rest, 7 showed neither profit or loss but 4 recorded a loss.

The 4 losses all arose out of the unwillingness of the respondents to include in work in progress different cost elements. The case specified bank interest of KD4,500 and administrative expenses of KD12,170, although these related solely to the Kuwait project not all respondents felt they could be treated as direct costs. The losses were as follows:

- 1 example KD4,500 (interest only not capitalised);

- 1 example KD12,170 (interest capitalised but administrative expenses treated as a period expense);

- 2 examples KD16,670 (interest and administration taken as period expenses).

The range of results was from -KD16,670 to +KD46,054, the mode was a zero result.

The presentation of the income statement reflected the above differences in that the 'turnover' figure was higher or lower depending upon the profit and loss recognition criteria adopted but otherwise uniform, except in 2 cases where certain of the expenses were treated as deferred in the balance sheet and not included in capitalised turnover. In one extreme case this resulted in turnover of KD80,000 in a set where the range was from KD80,000 to KD229,780 and the majority were clustered around KD184,000.

As regards balance sheet presentation, the only differences within the sample arose as a result of the different profit/expense recognition decisions. No respondent capitalised the leased assets; all showed the capitalised contract costs as work in progress, all recognising a profit showed the profit element separately in the balance sheet, all showed the receipts from the client as a liability.

Comparison

It is striking that neither the French nor the British samples produced anything like a uniform response to the long term contract problem, although the same proportion of the French (11 out of 15) preferred not to take a profit. The responses overall between the two countries showed remarkable similarities in both having a spread of interpretations over the same data. The main difference between the two countries is the capitalisation of the lease and the balance sheet presentation. To illustrate the latter, the following re-states a 'neutral' British respondent against the majority French balance sheet:

Assets	British KD'000	French KD'000	Liab'ties	British KD'000	French KD'000
Plant (net)	92	–	Lease obligation	95	–
Wk in p'gress	57	184	Receipt in advance	–	130
Cash	16	16	Bank loan	50	
50					
			Share Capital	20	20
	165	200		165	200

(Table 8.4)

The Parent Company

This element contains no single over-riding issue. There is a series of issues surrounding the disposal of the headquarters and building of new headquarters. The disposal of the old premises is as a result of compulsory purchase by the government and this gives rise to a loss, which possibly might be treated as an extraordinary item.

The headquarters is replaced during the year by new construction which takes place during the year. A US Dollar loan is negotiated for this purpose. A government grant is received. The issues involved are: possible inclusion of loan interest in the cost of the asset; treatment of Dollar liability at the year end, and if a provision is created arising from the foreign exchange movement, treatment of the provision; treatment of the government grant.

treatment of this is open to question. The treatment of leases would inevitably be different, as discussed in relation to the subsidiary.

Additional plant is purchased during the year, but thanks to the change of headquarters, the new plant attracts high depreciation allowances for tax purposes. This offers the question of whether or not to provide for deferred taxation and similar issues.

True and Fair View

SSAP 6 defines extraordinary items as those which 'derive from events or transactions outside the ordinary activities of the business and which are both material and expected not to recur frequently or regularly'. Such items are shown separately in the income statement after profit on ordinary items after taxation. The loss would be in the region of £50,000 which should be compared with an opening net worth of £265,000. It is not unreasonable to expect that it would be considered as both out of the ordinary and material, and therefore treated as extraordinary.

The Companies Act 1985 (Schedule 4, para 26(3)(b)) allows that the cost of an asset may include 'interest on capital borrowed to finance the production of that asset, to the extent that it accrues in respect of the period of production'.

The government grant may either be offset immediately against the acquisition cost of the asset, or treated as a deferred credit and released to the income statement over the life of the asset. If treated as a deferred credit it should not be accounted for as part of shareholders' funds (SSAP 4).

SSAP 20 requires that long term monetary items are re-stated in the balance sheet to closing rate, and the resulting exchange gain or loss should be closed to the income statement as part of ordinary activities. The standard does mention in passing that it considers there to be some interaction between exchange differences and interest rates, and theoretically there might be an argument for an exchange loss incurred during the construction of an asset to be included in its cost.

SSAP 21 on leasing specifies that where an asset is subject to sale and leaseback and the lessee effectively retains the use of the leased asset for the rest of its working life, then no profit on disposal should be recognised. The lessee should either carry the asset at its historical cost and show the lease liability in effect as a loan, or recognise the new asset value but treat the disposal profit as a deferred credit to be offset against depreciation. In this case therefore the respondents should show a lease liability of £22,000 and either a plant asset of £22,000 and a deferred credit of £2,000, or a plant asset of £20,000.

Deferred taxation should be provided under SSAP 15 in respect of the new plant, with the caveat that this may be ignored if not material.

Analysis of results

Two-thirds of the British respondents treated the loss on disposal of the headquarters building as an extraordinary item. In the Fourth Directive format generally used by British accountants (expenses by function, presentation in list) the extraordinary result is disclosed after tax on ordinary activities, and is therefore adjusted itself for tax.

Of the 10 respondents treating the loss as extraordinary, 1 had because of time constraints submitted a result without any tax adjustments, 6 adjusted for tax and 3 did not. This is probably not an accounting problem as such but rather a difference of opinion on the question of whether the loss could ultimately be used for tax reduction since it was capital in nature, not revenue.

Although the Companies Act permits capitalisation of direct interest cost, only 1 respondent included interest on the US dollar loan in the construction cost of the new headquarters. As regards the government grant, only 3 respondents treated this as a deferred credit while 12 took it directly as a reduction of the asset cost.

All respondents converted the Dollar loan at the closing rate, and 14 treated the resulting loss as a revenue item (1 respondent took it to reserves). Of the 14 treating it as a revenue item, only 5 allocated the loss to the finance section of the income statement while the others included it variously in either cost of sales or administration expenses. SSAP20 (para 68) says that where the loss arises from financing transactions it should be shown as part of ordinary activities and in the interest and similar charges section.

Since the format giving expenses by function is not used in France, its use is not germane to the comparative study, but it is interesting to note that 4 of the British respondents did not use it (or any other Fourth Directive format), and of those using it there was some variability in allocating different expenses to different functions.

The treatment of the sale and leaseback was also nearly uniform as regards asset value: 13 recognised a profit on the sale and showed the asset subsequently at the resale price rather than original cost. There was less unanimity on the treatment of the 'gain' arising. Of the 13 cases where a profit arose, in 3 it is not clear from the workings where the profit subsequently appeared, 5 have taken the profit directly into the income statement (one acknowledging that this was contrary to the standard but the amount was immaterial), 1 took the profit to a revaluation reserve and 4 have released part of the profit and carried forward the balance – treating it in effect as a deferred credit. The 4 releasing part of the profit have credited it against interest charges, albeit the more logical treatment might have been to use it to reduce depreciation.

Overall the income statements tended to show a much greater degree of unanimity than for the subsidiary, except as regards the allocation between functions. Net profit on ordinary activities before tax varied from £236,098 to £347,516. The main elements of difference within that range are the treatment of the loss on disposal as extraordinary or not, and the inclusion in some cases of a provision against loss in the subsidiary. 11 respondents were in the range £330,000 to £347,516.

Only two respondents provided for deferred taxation, some of the others had taken the view that insufficient information about tax written-down allowances was available, or that absence of deferred taxation in the opening balance sheet implied that the company did not routinely provide for deferred tax.

Image Fidele

The idea of extraordinary items is new to France. The accounting decree of 29 November 1983 simply specifies (art. D14) that the extraordinary result consists of items which do not derive from the ordinary operations of the company. The PCG82 does not provide guidance on this. Lefebvre 86 takes the view that the extraordinary result includes (in the Anglo-Saxon terminology) both exceptional items (ordinary but remarkable in view of their size or incidence) and extraordinary items (not part of the ordinary trading pattern). In this case the distinction between a (British) exceptional item and a (British) extraordinary item is not important and the disposal loss could figure in this section.

PCG82 allows (p98,p100) that interest incurred during the period of construction of an asset may be included in the capitalised cost of the asset. Where a company has liabilities denominated in a foreign currency, these are converted at closing rate (p104/5). Where a loss has occurred this should give rise to a provision charged against the profits of the period. However the accounting calls for 2 adjustments: (1) re-statement of the loan/recognition of the loss as an asset (called 'conversion difference'); (2) debit to income statement and creation of provision in balance sheet.

Where a company receives a grant for the acquisition of an asset, this is treated as a deferred credit (PCG82 p115) and released to the income statement on the same basis as the asset is depreciated. The release of the deferred credit should appear in the extraordinary result. The deferred credit itself appears in shareholders' funds, but after the 'net position' sub-total.

There are no regulations on the question of sale and leaseback. Lefebvre 86 notes (par. 1651) that two practices are found: (a) the creation of a deferred credit which is released to profit and loss over the life of the contract; (b) recognition of a disposal profit with disclosure in a note concerning the leaseback. Lefebvre recommends the second course.

There are similarly no regulations on the question of deferred taxation and Lefebvre (par 2886) notes that general practice is to ignore deferred tax. The other question which arises in this connection is that in order to claim tax allowances, an asset must be depreciated in the accounts by at least the amount of the allowance claimed. This gives rise to a situation where the depreciation charged is not economic depreciation. The Commercial Code (art. D13) requires that in this case the economic depreciation is charged in ordinary items and the additional tax-driven depreciation should appear in the extraordinary result. In the balance sheet the extra depreciation is not deducted from the asset, but shown as a special reserve within shareholders' funds.

Analysis of results

Fixed Assets: all respondents depreciated the old headquarters building for 11 months of the year, thereby effectively reducing slightly the disposal loss, and all showed the disposal as an extraordinary item. Only two respondents took the option available to them of capitalising the interest costs of the Dollar loan used to finance the construction (and none ventured into the possible argument that if the interest on the loan were capitalised, then the exchange loss might also be a candidate in view of the theoretical relationship between between interest rates, inflation and exchange rates).

All respondents recognised a profit of F20,000 on the sale and leaseback of new plant, but 4 out of 15 chose to treat this an item to be matched against lease rentals and only allocated 25% to the year under review. The presentation within the income statement was to show (in all cases) the sale price of F220,000 as extraordinary revenue and the historic cost of the plant (F200,000) as an extraordinary expense, while those deferring part of the revenue then showed a further debit to extraordinary items to create the provision.

Depreciation seemed to cause some problems, but these may have resulted from the way in which the original case was framed. The intention was that economic depreciation for plant was 25% straight line, whereas tax depreciation was 33.33%; 6 respondents took this position and therefore provided for additional (tax) depreciation of a significant size in the extraordinary result. The other 9 used the tax depreciation rate as the normal one and one noted that as there were no brought forward tax depreciation adjustments in the opening balance sheet, he had opted for the tax rate. Where the original study was obviously specific about economic versus tax depreciation in relation to plant acquired near the end of the year, then all respondents showed a separate tax depreciation figure in the extraordinary result.

The government grant was treated as a deferred credit to be amortised to income in line with depreciation by 13 respondents, but 2 took the grant directly into revenue in 19X1. This would have been correct if it were considered to be a revenue grant, although the case study seems quite clear that the grant related to the construction of the new premises. All respondents who treated the grant as a deferral also released the 19X1 allocation through the extraordinary result.

All respondents reconverted the US Dollar loan at the closing rate, giving rise to a provision of F109,400. In two cases the income statement debit was shown as part of the extraordinary result, whereas the norm was for the provision to appear as part of the financing.

Comparison

Inevitably the different approach to leasing provides a different set of measures concerning both asset values and disposal profit. This difference spills over into the different approach to the extraordinary result, with most French respondents recognising the disposal profit on the leased-back asset as an extraordinary item. The extraordinary result also contains tax depreciation and adjustments relating to the government grant in the French version and both revenue and expense are disclosed. In the UK version only the loss on disposal of the headquarters is treated as extraordinary and this is shown after charging tax on ordinary activities.

Although the British accountants had a choice in their treatment of the government grant, 80% opted for using it to write down the cost of the asset. The French regulations require it to be treated as a deferred credit and released in line with depreciation. The British standard does not allow the deferred credit (if that option is chosen) to be shown as part of shareholders' equity, whereas the French regulation requires it to be included there. Whichever option were exercised by the British accountants, net worth would be smaller than under the French approach.

Both sets of respondents have translated the Dollar loan at the closing rate and both recorded an expense for the difference. However, the French approach, as detailed above, requires the creation of double provisions so that typical French respondents have an extra asset of F109000 and an extra liability of F109000 compared with the British respondents.

Consolidated Accounts

In as far as this study concerns the implementation of the Fourth Directive and the Fourth Directive does not concern itself with consolidated accounts, the results for the 'Alpha Group' in the case study are not relevant. It was decided to obtain group accounts primarily for the sake of completeness, and for the same reason the results will be commented on briefly here.

However, the only general issue involved concerns the methodology for the choice of exchange rates at which to translate the foreign subsidiary, and the treatment of the translation difference arising. There are no additional measurement issues in that the consolidated accounts will otherwise simply replicate the differences observed at the individual company level. Although the Seventh Directive has been implemented in France, companies have freedom to use the gaap of the main markets where they operate.

True and Fair View

The object of group accounts is to show the situation of the group as though it were a single entity (SSAP14). In this case the subsidiary is wholly-owned and the only operational problem is that the subsidiary's accounts are denominated in a foreign currency. SSAP20 would require that these should be converted either using the temporal method where the subsidiary operates in direct extension of the parent's trade or using the closing rate/net investment method where the subsidiary is quasi-independent.

The case study was designed with the intention that respondents would be cued to follow the temporal method. SSAP20 in introducing the net investment method mentions 'the investing company may look forward to a stream of dividends, but the net investment will remain until the business is liquidated' and in introducing the temporal method 'for most investing companies in the UK and Ireland foreign operations are normally carried out through foreign enterprises which operate as separate or quasi-independent entities rather than as direct extensions of the trade of the investing company'. The case study specifies that (a) it was the parent which actually had the contract to build in Kuwait, (b) that the subsidiary was created specifically to carry out the contract and (c) parent company personnel were running the contract. The intention was to suggest that this was indeed the exceptional case for which the temporal method was appropriate.

However, all the respondents opted for the net investment approach. All translated the balance sheet at the closing rate and took the exchange difference arising on the net investment to reserves in the consolidated balance sheet. It may be that the respondents considered which method to use and decided that the facts left the decision open to interpretation, although in that case one might have expected that one at least of the respondents would have chosen the temporal method. Alternatively it may be that, since the standard makes it clear that use of the net investment method is regarded as the norm, accountants no longer consider using the temporal method. If that is so, this may be the type of situation foreseen in the 1983 legal opinion where what is 'generally accepted' differs from the standard.

Image Fidele

Lefebvre recommends (para 4701) that the closing rate method be used for the balance sheet, except where the subsidiary is a 'simple extension of the activities of the parent company', in which case the subsidiary may be treated as a branch. The income statement may be translated either at the closing rate, or the average rate, or using a mixture depending upon the type of transaction. The translation difference may be taken directly to the balance sheet to appear under a separate heading within the shareholders' capital section, or it may flow through the income statement with the further possibility of amortising the difference on monetary items over their expected life. Lefebvre does not indicate either any preference between the methods or any criteria for selecting one method over the other.

The majority practice (9 examples, or 60%) was to translate on the net investment basis, using the closing rate for the balance sheet, the average rate for the income statement and showing the translation difference as part of equity in the balance sheet. The other six examples used a variety of methods: 2 used the temporal method (monetary assets/liabilities at closing rate, others at historical rates, income statement at historical rates) while the other 4 used mixed approaches between the two. One example specifically mentioned SFAS52 (the US translation standard) as the model.

The other point emerging from the consolidation was that 7 examples (47%) took the opportunity to switch their accounting policies on leasing from that used for the parent company and subsidiary individually. These companies re-stated their balance sheets to capitalise the leased assets, however they did not all re-compute the profit measurement by calculating economic depreciation and interest and deleting rentals. Some respondents simply used as their depreciation figure a sum equivalent to rental less interest, so that there was no change in the profit measurement.

Comparison

Evidently there is much less uniformity on the French side than the British concerning translation methodology. Presumably this might have been predicted in that consolidation has been a requirement in Britain for nearly 40 years, and therefore translation methodology is much more worked out than in France where consolidation has only just become a legal requirement.

General Acceptance of Accounting Principles

One of the objects of the empirical research is to examine the degree of similarity between the 'true and fair view' of the data and the 'image fidele'. As has been shown in the detailed discussion of the response to the different elements of the case study there appears to be a great deal of variability in measurement not only between countries but between accountants within each country. However, the question of whether or not there is a consensus, i.e. which accounting principles are generally accepted, can also be approached by extracting the accounting decisions and representing the responses purely in terms of those.

This evaluation calls for some definition of what constitutes 'general acceptance'. Such a definition must, to an extent, be arbitrary since there is no established definition of what constitutes general agreement in accounting. A simple majority seems unconvincing since it allows for a wide degree of disagreement, so the definition selected is a two-thirds majority. In the table below, the accounting decisions offered are listed, and a summary given of responses to indicate (i) whether or not there is a consensus in the response and (ii) the number of responses. The table also indicates whether or not the regulations allow a choice in respect of the decision:

Accounting Decisions in Case Study

	Decision	Choice Avail.	British Results	French Results
	Subsidiary			
	Long term contract:			
1a	Recognise profit	Yes	No (11)	No (11)
1b	Recognise loss	Yes	N/C	N/C
2a	Capitalise all costs	Yes	N/C	N/C
2b	Capitalise some costs	Yes	Yes (15)	Yes (15)
3	Turnover shown	Yes(B)	Yes (12)	Yes (15)
4	Offset client advance	No	Yes (15)	No (15)
5	Capitalise lease	No	Yes (14)	No (15)
	Parent			
6	Compulsory purchase as Extraordinary item	Yes	Yes (10)	Yes (15)
	Government grant used:			
7a	– to write down asset	Yes(B)	Yes (12)	No (15)
7b	– as deferred credit	No(F)	No (14)	Yes (13)
8	Interest capitalised	Yes	No (14)	No (14)
9	US $ at closing rate	Yes(F)	Yes (15)	Yes (15)
10	FX loss to P&L	No	Yes (14)	Yes (13)
	– in finance costs	No	N/C	Yes (13)
11	Lease profit to P&L in first year	Yes(F)	N/C	No (11)
12	Capitalise leaseback	No	Yes (15)	No (15)
	– at sale price	Yes(B)	Yes (13)	–
13	Tax depreciation in Extraordinary result	No	No (15)	Yes (15)

(Table 8.5)

The decisions have been numbered on the basis of treating as one decision those which are inter-dependent such as whether to capitalise all costs of the long term contract or only some. This leaves 13 independent decisions, of which 6 are in areas where the regulatory framework does not allow a choice for either group.

In the six decisions where there is no choice, only one, the foreign exchange loss provision being charged to the profit and loss account, concerns a situation where the regulations are the same in both countries. The others deal with the treatment of finance leases, sale and leaseback, client advances under long term contracts and charging additional depreciation in the extraordinary result. Clearly in circumstances which involve any of these accounting decisions the true and fair view and image fidele will be systematically different.

There were two decisions where the British accountants had a choice but the French had none: treatment of the government grant and recording turnover in the subsidiary. In the case of the government grant the British consensus was to write down the asset rather than treat the grant as a deferred credit, while the deferred credit approach is obligatory in France. The bulk of the British sample recognised turnover in the subsidiary and were therefore in agreement with the French sample.

In the 5 decisions where choices were available to both groups, the level of agreement was quite high: in 4 each group made the same decision, and in the fifth neither group was able to register a consensus. However, this fifth decision was the vexed question of which of the subsidiary's costs should be treated as work in progress, and the lack of agreement on this point combined with the relative importance to the example of the numbers involved meant that the final profit figures were affected substantially, giving the impression of much less unanimity.

Statistical Analysis

The small number of respondents (30) and the restrictions imposed by having only 3 results in the smallest sub-groups (see table 8.3) prevent the use of statistical techniques in analysing the data since such techniques call for much larger samples in order to generate statistically significant conclusions.

However, since the aims were to test for degree of conservatism and degree of uniformity, this can still be approached, albeit perhaps crudely. The comparison of the statistical mean of key elements of the financial statements of each group of responses provides some measure of conservatism by the groups as a whole, while the standard deviations of these measurements within groups shed light on the comparative degree of uniformity and the closeness of the consensus on a true and fair view of the transactions. It should be born in mind, though, that the underlying data on which the statements are based are artificial, and slightly different data would have given rise to correspondingly smaller or larger variations.

Given that the original data assumed an exchange relationship of F10.00 = £1.00 the two sets of data can easily be converted to a uniform currency. However, tax differences will give rise to a systematic difference in after tax profit measurements and net equity. Consequently the underlying data were adjusted to cancel out all tax deductions and a notional net equity figure re-computed – although the relationship between net profit and equity in this case is so close that in effect the adjusted equity figure is provided as an illustration only.

The accounting numbers which were selected for comparison are the following:

Turnover

Profit before interest and tax

Interest charge

Profit before tax

Extraordinary items

Profit after extraordinary items

Total assets (net of depreciation)

Net equity.

The rationale for the choice of these figures is that turnover, total assets and net equity are all frequently used as indicators of size and if measurement differences distort messages, then these indicators have significant impact on analysts' perceptions of a company. Since France has adopted the presentation of expenses by nature and British accountants typically use a presentation by function, the intermediate points between turnover and net profit before interest and tax are not directly comparable, but thereafter the profit and loss accounts can be compared on a line by line basis.

Middle East subsidiary:

	British sample		French sample	
	Mean	**Std dev.**	**Mean**	**Std Dev.**
Turnover	136,644	83,407	185,930	36,432
Profit before int	(12,014)	50,759	12,793	23,357
Interest	(4,675)	5,619	(4,031)	1,654
Profit before tax	(16,689)	51,344	8,763	22,812
Total net assets	168,711	51,670	208,938	23,091
Net equity	2,711	51,256	28,763	22,812

(Table 8.6)

Although the sub-sets within each group are small, the statistical means for those were also calculated:

	British sample			French sample		
	Capital	**Province**	**Corp**	**Capital**	**Province**	**Corp**
Turnover	158,487	108,972	148,304	185,715	211,594	143,659
Pft bef tax	(8,574)	(44,746)	23,194	1,794	27,109	(5,557)
Tot Net Ass	181,154	146,199	188,847	201,794	227,635	194,443

(Table 8.7)

For the Middle East subsidiary the data shows that the British results are more widely divergent than the French, so in that case the expected result is achieved, but in terms of conservatism in fact the French result is less conservative than the British. The British result contains at least one fairly extreme measurement which might be classed as an outlier, but even removing the outlier the mean result remains more conservative than the French. The actual degree of conservatism cannot of course be measured since the numerical differences as such are a function of the original data.

On all three major size indicators, turnover, total assets and equity, the mean British result would suggest a smaller company than the mean French result. However, the degree of variability within the British result suggests that the mean does not of itself convey a representative image.

Within each group the sample is too small to draw conclusions, but it is interesting to note that the British corporate preparers produce the highest mean profit within the British group, which might have been predicted on a Watts and Zimmerman basis, or simply even a shareholder reporting basis. The French corporate preparers show the lowest mean result (in fact a loss) of the French group, perhaps reflecting a continuing pre-occupation with tax measurement.

Parent Company results:

	British sample		French sample	
	Mean	Std Dev	Mean	Std. Dev.
Turnover	1,331,733	44,577	1,345,000	76,572
Profit bef int	340,340	28,012	352,598	78,076
Interest	19,478	10,374	33,692	19,950
Profit bef tax	320,862	30,102	318,906	86,169
Extraord items	33,770	24,538	58,182	14,444
Profit aft ex	287,092	19,003	260,724	77,221
Total net assets	865,802	28,802	860,227	86,214
Equity	551,862	18,339	538,895	102,203

(Table 8.8)

Curiously enough, the results for the parent company suggest that, judged on the mean, the French and British measurements are broadly in line, but the standard deviation for the French sample is higher on almost every measurement implying that there is far less uniformity on the issues addressed in this part of the case study: there is not a clear consensus on a true and fair view of these transactions from a French perspective.

In terms of the overall conservatism there is little that can be deduced from a comparison of the mean: the profit before tax figure is most closely comparable in its make-up and the two sets produce nearly identical mean calculations here. The French measure of extraordinary items is significantly higher, but this reflects the incorporation of the tax-driven depreciation at that point. Consequently one may say that the French measurement after extraordinary items does give a more conservative profit, thus confirming Gray and Davidson and Kohlmeier, but that profit on ordinary items before tax is comparable.

The measurement of total net assets is similar between the two sets, despite the difference in approach to lease capitalisation, because the incidence of the leased assets is small in this case.

Conclusion

The broad conclusion which might be drawn from the empirical study is that there is relatively little uniformity or close consensus amongst either the British or French respondents in their measurement of a true and fair view of the transactions contained in the case study, and also that there is 'some support' for the notion that the French net profit measurement will usually be more conservative than the British.

However there are difficulties about drawing conclusions which are too emphatic in that the sample is small, and also the statistical measures are unsophisticated and produce comparative figures whose magnitude is a function of the original data. For example in the parent company balance sheet a greater use of leased assets would automatically have produced a wider difference between British and French mean total net assets.

There is a certain amount of distortion in terms of respondents making different assumptions about some matters, but notably depreciation rates. The analysis of the results by comparing responses to the problems deliberately posed suggests a high level of agreement in the areas where choice is available. If one looks at the underlying transactions one can see that British respondents had considerable difficulties in dealing with the long term contract problem in the subsidiary which manifested themselves in many different ways: turnover, cost of sales, interest measure etc. thus providing a level of variability which was not replicated in the parent company transactions.

Looking at the most variable French result, the parent company, here again underlying transactions throw additional light: there was significant disagreement between respondents about the rate of economic depreciation to be expensed. This had an impact both in the net profit measure and total net assets, and a uniform approach to depreciation would have provided lower standard deviations. The original data was intended to suggest an appropriate depreciation rate, albeit obliquely and it is difficult to be certain whether the choice of varying rates was due to a lack of clarity in the French version of the case study or lack of familiarity by the French accountants with the concept of economic depreciation.

At a detailed level the strongest conclusion which emerges is that while there is some reasonable consensus about the net profit measurement, the precise way in which this is presented, the element which the Directive was most likely to be able to address, still contains great scope for differences. This is obvious where there are systematic differences such as the treatment of assets held under finance leases, less obvious when it comes down to questions as to whether interest paid on loans to finance the construction contract should be treated as cost of sales in the subsidiary and capitalised into work in progress or taken as a period expense into the subsidiary.

Variations in treatment within each jurisdiction are quite clear from the results, and it is by no means clear that a user would obtain a greater consensus by comparing two reports from the same country with each other than by comparing one report from each country.

CHAPTER IX

Conclusion

The legitimacy, and likely success of, attempts to harmonise accounting across national boundaries is an issue which is contested by regulators and researchers in international accounting matters. The direct costs of harmonisation are considerable in terms of both the costs of formulating regulations and then of applying them, quite apart from the consequential economic effects which may arise. It is potentially therefore of some interest to monitor harmonisation when it takes place.

Harmonisation of accounting has been taking place in the framework of harmonisation of company law within the European Community. This offers the opportunity to observe harmonisation in action in possibly its strongest form, through statutory intervention in accounting, as opposed, for example, to voluntary adoption of international norms by national professional bodies.

This study has set out to analyse a particular case of harmonisation, the adoption in France of the true and fair view, as an example of harmonisation, the process through which it takes place and the effects which it has on accounting practices.

The true and fair view was chosen because its origins are British and it provides a clear and identifiable import into the legislation of France as a result of its adoption by the European Community as the objective of accounting reports under the Fourth Directive. In addition the true and fair view is so indeterminate in its nature that it poses problems of interpretation for any jurisdiction which is adopting it, and consequently offers opportunities to observe different influences at work in each regulatory environment.

The study has considered the true and fair view in its British context and then followed through the process of its adoption by the European Community and its incorporation in French law. In the process the study has attempted to address issues of whether harmonisation achieves change which would not otherwise have happened, whether the accounting which is produced gives a different picture from that given prior to harmonisation, and whether the picture given is close to that in another post-harmonisation environment.

The analysis has been presented as follows: initially the literature in this area was reviewed, both that which aims to identify important differences between accounting environments and that which addresses the issues surrounding harmonisation. In addition the literature which deals with accounting change within a single environment was also reviewed to throw light on the process by which regulation takes place.

The true and fair view has been analysed from the perspective of its function within British accounting practices and then in the context of its adoption as part of the Fourth Directive by the European Community. This was followed by a review of the development of accounting in France in the period since 1945, with particular reference to the influences which have shaped regulation and practices, and a consideration of the impact of the true and fair view on French accounting.

Two empirical studies set out to provide evidence of (a) whether or not the adoption of the Fourth Directive brought about any change in accounting measurement; and (b) whether, after harmonisation, the true and fair view displayed by French accountants approximated to the true and fair view operationalised by British accountants.

In presenting the conclusions which the study draws from this analysis, the same framework will be used.

Influences on accounting

The object of the literature review in the early chapters was to establish an analytical framework against which to evaluate the case of French use of the true and fair view. Initially the literature which specifically addresses issues in comparative international accounting was considered. This literature includes studies which attempt to classify national practices and the factors which determine the nature of these.

It was found, though, that these studies over-simplify the issues and cannot provide a model for how harmonisation might take place. Such studies appear to require that the number of factors operating to influence accounting in any one jurisdiction is relatively small, and that these factors operate systematically under all circumstances to produce a consistent set of principles and practices. It is thought that these pre-requisites are unlikely to exist in the real world where accounting practices are formed over a long period of time and in response to particular pragmatic issues which arise.

More recent developments in understanding how accounting change takes place have advanced to the point where different forces are seen to be brought into play by different accounting issues, and the whole process of regulation is seen to be political. Accounting is seen as embedded in a social context and changes may come about or be influenced not only in response to technical issues but also because of a desire to preserve or enhance social status or power; thus factors may influence outcomes which are not directly linked to the techniques of accounting.

In this context prior assumptions about cause and effect relationships between accounting regulations and the economic environment may not provide a reliable predictive model. However, classification studies do serve some purpose in directing attention towards some institutional differences which need to be taken into account, such as the different approaches of code law and common law, the organisation and status of the profession, the sources of capital for commercial activity and the role of taxation.

Given the inability of comparative classification to provide a model, the analysis then turned to the literature which discusses accounting change within individual national jurisdictions. This suggests that while there are some interest groups such as the profession, the state, managers and the capital markets with continuing roles to play in relation to accounting, on any particular issue there will be several interest groups affected, and both their identity and the nature of their interest will differ from issue to issue. In addition influence may be brought to bear by conflicting sub-groups within the same general class. Accounting makes phenomena visible or leaves them invisible and the choice of accounting methods will direct attention in particular ways or serve particular interests, so different accounting issues will have the possibility of benefiting or disadvantaging different groups.

The literature suggests that the nature of the influence brought to bear will vary from issue to issue and change in accounting occurs when a constellation of influences converge. However this implies that one cannot predict exactly what forces will converge on a future issue and research into change should proceed not from a predictive model of accounting decisions, but by analysing events to deduce retrospectively what influences were in evidence on a particular issue: research into accounting change should proceed from a historical, genealogical perspective.

This approach implies that one proceeds from the events to the influences, but the literature also suggests that there are some groups which have a continuing presence in accounting debate. Although their position may vary from issue to issue,it is still possible to outline the situation of some of these groups. The literature suggests that the accounting profession, the state, managers and the capital markets all have continuing roles in accounting debate.

The accounting profession may be seen to have a role to advance and protect the standing of its members (although the members will not necessarily have uniform interests). In general terms this is operationalised as controlling entry into the profession and demand for professional services; the preservation of an esoteric cognitive base is seen as important in supporting this position.

The profession's relationship with the state is seen as important but ambivalent. On the one hand the state may have a considerable role in bolstering the demand for the profession by acting, for example, to make audit compulsory. On the other hand the state may reduce the profession's status by de-mystifying the accounting process and by keeping to itself the responsibility for accounting regulation.

The state though is equally not a uniform influence – it includes many sub-sets with sometimes competing interests. The state as tax gatherer has overt motivations which may conflict with political, social or economic objectives. Different organs of the state have different means, motivations and opportunities to influence accounting debate.

Accounting information is also important for the capital markets, providing motivations for both company management and information users to wish to influence its provision. It can be seen that there are powerful interest groups potentially concerned with accounting regulation and examination of their activities should be part of the analysis of any historical example of accounting change.

The review of the literature dealing with influences on accounting change lead to a view that comparative international classifications identify institutional differences which need to be considered, but that the influences which shape individual changes need to be considered in relation to those individual changes since their operation will not be either uniform or systematic.

Harmonisation

Harmonisation is a particular type of accounting change, and in considering an example of harmonisation it is necessary to pursue not only the factors which influence accounting change in general, but the also the special peculiarities which pertain to harmonisation, and in this context harmonisation through statutory intervention.

The review suggests that European Community harmonisation was motivated at a national political level by a desire to move towards a Europe-wide capital market with accounting information on companies which could be readily understood through the Community. This stance was supported by a pragmatic view that the Community needed to establish minimum levels of reporting to avoid the creation of regulatory havens. Subsequently the internationalisation both of capital markets and of corporate activity have lead to a situation where there are strong pressures for corporate reporting to be readily understood across national boundaries – but also to a situation where US reporting is being adopted by preparers.

The process of creating harmonised reporting is inevitably a political one, with the outcome being legislation which includes a series of compromises. Commentators observed that corporate reporting served different purposes within different jurisdictions, being angled towards different uses and users. Accounting in each jurisdiction represents necessarily an accumulation of past legislation, jurisprudence and practical solutions to local problems, and harmonisation is not possible without disposing of the accumulated past. However, most member states can be expected simply to add Community requirements on top of existing requirements and adapt Community directives as well as they can to minimise the disruption of their domestic situation.

The effect of this is to dilute the harmonisation which is achieved, and this operates in three areas. Firstly, at the time of formulation of a harmonisation directive, conflicts between different views of a desirable solution lead to the inclusion of optional elements, so that the directive as adopted in one state is not exactly the same as that adopted in another. Secondly, if the directive is grafted on to existing requirements, it moves the existing practices in a particular direction, but the accounting which results will not necessarily be close to that produced in another state which has similarly adopted a directive by adding to, rather than replacing, existing rules. Thirdly the way in which the rules are operationalised is likely to differ from one country to another: the notion of the true and fair view is a classic example of an accounting requirement which means different things to different people.

This process of dilution and interpretation is also affected by the nature of the influences and the institutions which are brought into play by the process – each country has its own framework for elaborating accounting regulation and operationalising it so that after formulation a harmonisation directive is received into different regulatory situations in each country. It may be that closer harmonisation might be achieved by different institutional structures and that there is a case for a more sustained analysis into the dynamics of harmonisation to throw light on to this. In particular the effects on harmonisation of the Contact Committee established to review implementation of the Fourth Directive might usefully be assessed.

True and fair view

It may be that the true and fair view is a useful site for explaining the dynamics and consequences of harmonisation since arguably its most striking single feature is that although it occupies a central position in British accounting legislation (the over-riding objective of financial statements is to give a true and fair view), the notion is undefined and indeterminate in its nature. It therefore holds out the possibility that different groups can have different interpretations which best suit their local circumstances.

The analysis of the true and fair view in British accounting in this study suggests that the signified, the underlying concept, is a dynamic notion which follows a continuing, but erratic, line of development. The evidence suggests that the use of the term or its predecessors in British company law was intended to provide for a mix of prescribed minima and flexibility, with the accounting profession left to elaborate the detail.

True and fair can be seen as partly a legal residual clause intended to cover situations not specifically foreseen in the legislation, and partly as a code term meaning the application of an accumulated collection of accounting techniques: generally accepted accounting principles (which have been elaborated in the context of a British legal and economic environment). If the general principle of its use is that the law prescribes a minimum and accountants elaborate this, the elaboration will result in a body of generally accepted accounting principles which is subject to evolution as circumstances and ideas change. Accordingly the 'true and fair view' of a company's state of affairs is a function of generally accepted accounting principles at the time the financial statements are drawn up. Financial statements drawn up twenty years apart but relating to exactly the same underlying transactions would not necessarily provide the same true and fair view.

In the context of accounting harmonisation it could be argued then that provided financial statements in each jurisdiction within the Community were drawn up according to local gaap, they would provide a true and fair view for that jurisdiction. Alternatively, unless generally accepted accounting principles are harmonised, the true and fair view does not produce harmonised accounting statements.

The analysis of true and fair poses a second question, asking whether the indeterminate nature which is its most prominent feature is accidental, or whether it may serve some purpose. The analogy is drawn with a conceptual framework, which in narrowing the choices open for accounting regulators also reduces the power of those wishing to influence debate. A tightly defined true and fair view might reduce the area open for discussion both at the regulatory level and at the operational level of auditor/preparer debate on individual statements.

The sociology literature which analyses the behaviour of professional groups also suggests that indetermination in the cognitive base of a profession serves to enhance the status of that profession. It can be seen that if, on the one hand, the true and fair view is the ultimate objective of financial statements, but, on the other, accountants are the only people who (after extensive training) can decide what this is, then the bargaining power of the accounting profession is very strong. If the true and fair view were thought to be reducible to a formula relatively accessible to non-accountants, the demand for the services of accountants would decline, or at least their status as professionals exercising their judgement would decline.

In terms of the harmonisation process it follows that the true and fair view offers in some senses a means of fixing an objective for accounting without seriously limiting subsequent debate. Its flexibility means that it could be accepted at the European Community level without excluding the possibility of further debate at implementation level in each jurisdiction. A secondary feature is that the use of such an indeterminate objective may enhance the status of accountants and so professional groups could be expected to support its adoption.

Analytical framework

The literature review provides a framework for approaching the adoption of the true and fair view in France along the following lines:

a) comparative international classifications suggest that some institutional differences exist which may influence the way in which accounting operates, specifically the legal base, the capital markets, the operation of taxation and the nature of the accounting profession;

b) the literature of accounting change proposes that change takes place when a constellation of influences come together on a particular issue. Consequently one cannot predict just what forces will affect specific issues, but it is apparent that there are interest groups which are important in accounting regulation such as the various elements of the state, the accounting profession and consumers of accounting information;

c) compulsory harmonisation of accounting across national boundaries involves considerable debate as to what form of accounting is to be adopted. This debate involves compromise both as to the form of accounting and as to areas which are left open for resolution by individual states. Legislation is also likely to prefer to deal with disclosure issues than measurement issues. Individual states are likely to graft Community-inspired legislation onto their existing company law rather than attempt to create an entirely new and consistent company law. Consequently the sum of company law is likely to remain substantially different from one state to another, although containing some common elements.

d) the true and fair view is an indeterminate term whose precise meaning can only be ascertained at any given time by reference to generally accepted accounting principles in a particular jurisdiction. As such it is a flexible term which lends itself to use in a harmonisation process because it can operate in different jurisdictions by reference to gaap in those jurisdictions – but at the same time it offers only a superficial harmonisation because those gaap are different in different jurisdictions. The flexibility of the term means that it does not circumscribe debate and is therefore likely to be useful to those wishing to influence the direction of accounting debate.

True and fair and the Fourth Directive

The objects of the Fourth Directive were both to provide a minimum standard of corporate reporting throughout the community and also to create harmonised accounting which would remove obstacles to trading across national boundaries. The drafting process for the directive started in 1968, well before British membership, and the original proposal was based on the German statute for public company reporting.

When the draft directive was exposed for comment in 1972, the Groupe d'Etudes, the European Parliament and the Economic and Social Committee all called for the inclusion of a true and fair clause or a similar device which would lead to reports closer to the Anglo-Saxon model. When Britain entered the Community in 1973 its representatives, concerned with work on the Fourth Directive, argued strongly for the inclusion of a true and fair clause.

The second version of the Directive (1974) acknowledged these opinions and established the true and fair view as the objective of statements but its use was modified in the third and final version (1978). This version made clear that the expected sequence of events would be that (i) a company would prepare accounts according to the Directive; (ii) it should consider whether the completed reports gave a true and fair view, and if not (iii) further disclosure should be made in the notes to the accounts. Only (iv) in the rare case where disclosure did not solve the problem could true and fair be used to over-ride the Directive's requirements.

It is apparent that the different negotiating teams involved in preparing the Fourth Directive had different views about what true and fair implied. The British negotiators were subject to great pressure from their colleagues to preserve the true and fair view, while the Germans found any degree of choice in company law very difficult to accept. The result was the compromise which the literature predicts, with true and fair built in to what started out as a German model, but with different groups having different ideas about what true and fair meant. Britain subsequently issued accounting standards which relied upon the true and fair view for a systematic derogation from the Directive, the Germans took the view, supported by a European Council minute, that compliance with the Directive automatically provides a true and fair view. The French took the view that the merit of true and fair lay in the additional disclosure requirement.

The Fourth Directive equally did not of itself resolve differences between different groups as to the purpose of accounts and the interaction of prudence with the other basic measurement principles. Some states leaned heavily towards creditor protection and measurement for tax purposes, so would be likely to lean more heavily towards prudence than those whose main interest is performance measurement from a shareholder perspective. The implication arising out of this is that as the Fourth Directive had not resolved these issues, the question of whether the Directive has any effect on them in an individual state depends to an extent upon how that state implemented the Directive. The literature of accounting change in turn would suggest that the thrust of implementation would depend upon a confluence of interests at that time.

French accounting before the Fourth Directive

It follows from that view of accounting change that an appreciation of how the Fourth Directive was implemented in France would depend upon the forces at work in accounting in France during the period of in which the adoption was being worked out – the genealogical approach requires that the change is set in a historical perspective.

The French economy underwent dramatic change after the Second World War and this provides a convenient starting point for analysing the forces at work. The literature suggests that potentially significant interest groups in this arena are agencies of the state, the accounting profession, business management and users of accounting information. In France various elements of the state have exerted a strong influence. Immediately after the war the state set out deliberately to re-organise and revitalise the economy, in part by nationalisation and by channelling investment in the nationalised sector.

The government set up a national council to prepare an accounting code for use in the nationalised sector of the economy. The government needed data to help with the management not only of the individual companies but also of the economy in general and this influenced the creation of a uniform accounting code which could provide comparative data. The code was angled towards measurement of value-added in response to economic planning needs.

However, the state as tax gatherer soon also became implicated in the elaboration of the accounting code. Where the code did not provide tight definitions or measurement approaches the tax authority supplied these and the system became closely imbued with tax measurement principles. This intertwining was expanded in the 1950's with the use of tax allowances to provide investment incentives and with the insistence upon the accounting code being used for tax returns. Consequently, although the code was initially intended only for use in nationalised industry, its use in the private sector became widespread and finally mandatory.

The financial reporting base was designed to measure value-added, and to produce measurements based on tax criteria. The information was primarily designed for the tax authority and other users, including the state for economic planning purposes, had to re-work the data for their own purposes. During the 1960's there was considerable re-organisation of business and larger groups emerged, and were forced to recognise the information needs of other partners: shareholders, international capital markets, international trading partners. One response to this was for large companies to produce a second, unofficial set of statements, often using US gaap.

Further pressure arose in 1968 when a series of strikes broke out, expressing, amongst other things, a desire for more active involvement by workers in their employer companies, and less secrecy about the firm's affairs.

The accountancy profession had been re-organised by the state immediately after the war but its main function was supplying specialist tax and accounting advice, and the attest function was not given much importance. The profession devoted the early post-war years to building up its training and examination structure and only in the 1960's turned to improving the techniques of accounting as such by publishing technical discussions and, from 1965, issuing guidance on technical matters. From this time on the professional body seems to have been keen to play a role in improving its cognitive base – which is perhaps also linked with the objective of improving the status of the profession.

The importance of the audit branch of the profession was heightened in 1966 by a requirement to certify that accounts were 'sincere et regulier', which offered the possibility of an expanded role for the profession. However this requirement came to be interpreted as providing accounts which complied with the law and the underlying records, rather than providing any economic assessment of the company's affairs. Cases where companies published sincere and regular accounts showing no losses and then went into liquidation served to bring this certificate into some disrepute. The government had created in 1967 a stock exchange supervisory body, the Commission des Operations de Bourse, which was quick to point out these shortcomings and press for better shareholder information.

The national accounting council wished to start work on updating the accounting plan in the early 1970's but was held back by the need to await agreement on the Fourth Directive. It is apparent that by this time there were a number of forces at work in the accounting arena: the state wished to encourage the development of companies which could compete on an international scale and felt that it should encourage the development of the capital markets; the structure of industry was changing with many more medium to large sized companies being created with information needs different from those of the small, family business; businesses needed accounting measurements to use with international partners; the accounting profession was keen to expand its role and take on board a more sophisticated approach to accounting, as well as anxious to escape from the old straitjacket of tax-driven accounting; employees were concious of the importance of having better information about their employers.

In general it seems that in the 1970's there was indeed a constellation of interests concerned with accounting which wished to move, for different reasons, towards a form of accounting designed less for the tax collector and more for other users. It could be argued that adoption of the Fourth Directive provided a focus for these forces but that they would have brought change in any event.

Implementation in France

The Fourth Directive was implemented in France through a new accounting plan (PCG82) which was given statutory backing with an accounting law in 1983 and came into use from 1st. January 1984. The new accounting plan was first exposed in draft form in 1979. The use of the PCG and therefore the national accounting council as the device for introducing the Fourth Directive meant that many interest groups had formal representation in the drafting process, and also particpated in the general promulgation of the draft. The exposure of the draft in 1979 opened up an intense debate which focussed in particular on the true and fair view (which in fact had not superceded the sincere and regular requirement but had been added to it).

Many regarded the true and fair view as the single most important change, but the package of changes included a number of significant additions to French reporting procedures. Many saw the true and fair view as being principally associated with the requirement to publish explanatory notes to the accounts, in which numerous additional disclosures would improve the quality of the picture given by the accounts. The other major change was the need to disclose details of the accounting policies and to apply the principle of consistency, thus removing one of the main methods of massaging the picture formerly given to shareholders.

The Fourth Directive required that where tax regulations were followed in accounting measurements the effect of these should be disclosed. This was operationalised in France by a decision that economic depreciation should appear in the operating result and additional depreciation for tax purposes should appear in the extraordinary result. In the balance sheet assets should be shown net of economic depreciation and any extra provision should appear as part of equity. This decision meant that, on the one hand, some tax distortions could be eliminated easily but, on the other hand, the notion of an extraordinary result in France would be quite different from the notion practiced in Britain.

The extent to which companies make disclosures to give a more complete picture and the extent to which companies are prepared to recognise any difference between tax depreciation and economic depreciation are both matters for which it is difficult to legislate. It is quite possible that the true and fair view could have been assimilated in the same way as was the sincere and regular requirement and not bring about a shift to a more judgemental approach. However, the existence of a groundswell of opinion that change was needed would operate against this. In addition the efforts made by those concerned with the drafting of the new accounting plan to ensure that a genuine shift took place may well have succeeded in ensuring that the adoption of a new signifier (the true and fair view) was accompanied by a new signified (notion of the objective of producing the accounting report).

There was no clear agreement amongst French accountants and users as to what the true and fair view implied in detail, but there was consensus that it meant accounts had to be prepared with a view to the needs of outside users. This of itself was a major change since sincere and regular had come to be interpreted as being in accordance with the facts and the law but without regard to the overall picture presented to the outsider. The main professional body saw it as the 'final test' applied to the statements to assess the significance of the information to the reader of the accounts. Others however queried the possibility of having a single set of accounts that answered the needs of all users – neither the shareholder nor the tax authorities were seen as specially privileged in this context. In the absence of any agreed set of priorities about user needs, the situation was left open for individual preparers and auditors to exercise their own judgement and preferences.

To an extent this could mean that the different groups interested in influencing French accounting could have a little flexibility in meeting their own needs. In terms of the new approach of the PCG82 it could be argued that some element of those needs had already been met. Evidently the need to satisfy the tax authorities had not been totally shaken off since the new accounting law had not repealed the requirement for all depreciation claimed as an expense for tax purposes to be charged in the shareholder accounts – but the disclosure rules promised clearer treatment, enabling an economic measurement to be made.

The COB was pleased with the insistence upon consistency and the need to consider the overall picture presented by the reports to outsiders, while financial analysts expected to be able to carry out more meaningful analysis with the additonal information and revised definitions of balance sheet categories. The accounting profession was being called upon to exercise more judgement in the preparation of accounts and this should in theory enhance their professional status. Some companies took the opportunity provided by the implementation in 1984 to revise their own internal procedures and indeed accounting policies, so adoption had an unintended side-effect in leading to a general reconsideration of accounting systems and policies by individual companies.

The literature shows that many of those concerned with preparing, auditing and using accounts expected that the implementation of the Fourth Directive and the adoption of the true and fair view would lead to a different approach to accounting. Although this indicates a shift in accounting thought, there is still the question as to whether the implementation of the Fourth Directive through the PCG82 did in fact lead to discernible changes in accounting measurements by French companies.

Empirical evidence

An opportunity to observe some effects of implementation arises from the fact that the 1983 statements of French companies were prepared according to the old PCG, while the 1984 results were prepared according to PCG82, but the 1984 figures were published in many cases with 1983 comparatives. It is therefore possible to compare some 1983 data as presented using the two different accounting plans. The effects of the adoption of the PCG82 would have been to cause some re-classification of assets and liabilities. Amongst these the most significant would be the requirement to separate out economic depreciation from additional tax depreciation. In the balance sheet the tax element should be removed from accumulated depreciation and shown as a component of shareholders' equity. The effect of the tax adjustment should be to increase both net tangible assets and equity.

One difficulty arises in interpretation since companies, as a transitional measure, were not required to recalculate their 1983 data and give 1983 comparatives. Of the 50 companies whose reports were examined all gave 1983 comparatives and 32 showed changes in their net tangible assets and equity. It is not possible to know whether the 18 whose assets and equity measurements did not change had taken a positive decision that there was no difference between the value of the assets as written down for tax purposes and that as written down on an economic basis, or whether they had simply decided it was not worth the effort of doing the new calculations.

Taking the extreme view that the 36% whose measurements did not change were of the opinion that tax and economic depreciation were the same, it still means that 64% of preparers responded immediately to the demands of the new approach and made a positive attempt to exercise judgement. The effects of their re-measurement were to add 4.5% on average to net fixed assets and increase equity by 1.76%. From the limited evidence of the sample, the effects of re-measurement were different in different industry sectors. The effect of re-measurement on performance indicators would be negative since an increase in equity would reduce the return on equity and return on capital employed ratios, and an increase in assets would similarly reduce the turnover/assets ratio.

The evidence provided by an analysis of corporate reports supports the idea that a real shift in attitudes can be discerned through the adoption of the Fourth Directive and the true and fair view. However, there is also the question as to whether the true and fair view obtained under the PCG82 was similar to the true and fair view obtained under the 1981 Companies Act in Britain. Had the harmonisation process succeeded in producing similar measurement approaches in two member states ?

If giving a true and fair view means providing financial statements according to generally accepted accounting principles, then as long as accountants in each jurisdiction comply with gaap they are giving a true and fair view, even though the actual measurements do not coincide. However, if harmonisation is to be meaningful, then presumably there is a need for the measurements to be at least similar. In order to test this a set of hypothetical accounting data was prepared and submitted to a sample of 15 professional accountants in each country with a request to prepare financial statements.

The hypothetical data concerned two companies, a parent and subsidiary, and included problems of the treatment of leased assets and of measurement of interim profits on long term contracts where accounting practices are different between the United Kingdom and France. The main incidence of these was in the subsidiary company and resulted in relatively large differences between national groups. However, the various sets of statements for the subsidiary demonstrated that there was divergence of opinion amongst accountants within each national group, and this was particularly wide amongst the British group.

It was clear that aside from areas where standards exist and allow choices there are also areas where preparers need to make choices and no guidance exists. In these areas, such as whether interest charged under a finance lease is capitalised into work in progress on a long term contract or treated as a period expense, and whether if capitalised it is shown in the income statement within cost of sales or as interest paid, there is no clear consensus and consequently no automatic comparability between financial statements within the same jurisdiction.

The parent company results did not exhibit as much variability as the subsidiary, but also did not include elements where the existing accounting practices were different as between the two jurisdictions. Here the mean results for the two samples were close to each other, although the French profit after extraordinary items was lower than the British. Within each sample group there was some variability, but in this case the French group gave a slightly higher internal variability.

The sample was too small to enable projections to be made reliably from its evidence. However, it demonstrated that there are areas of accounting practice which remain substantially different between the two jurisdictions and which therefore provide a different perspective. At the same time the evidence serves to remind that although the harmonisation debate focusses on comparative national differences, there remain substantial areas within national jurisdictions where accountants have choices which result in a different picture being given.

In terms of the success or otherwise of the European Community harmonisation programme the evidence indicates that a degree of comparability has been achieved, although the measurement provided by a French true and fair view is not the same as that provided by a British true and fair view. Underlying differences in generally accepted accounting principles need to be identified and eliminated to achieve a greater degree of comparability.

Conclusion

This study has focussed on the adoption by French accounting of the true and fair view as the object of financial reporting in compliance with the European Community Fourth Company Law Directive. It has postulated that the process of harmonisation would involve both compromise between different national traditions at the stage of drafting directives and further compromise at the implementation stage between the directive and existing national legislation. It further suggested that the nature of the end result in a jurisdiction would depend also on the prevailing forces which had some interest in influencing accounting.

In considering the true and fair view within its original environment in Britain the view was put forward that it operated as a legal residual clause and had come to be synonimous with generally accepted accounting principles. Once true and fair entered the political arena of the drafting process of the Fourth Directive it became subject to compromise and was slightly adapted. At the same time it remained sufficiently flexible to allow different national groups to have different views of its meaning, with the poles of the spectrum represented by Britain at the liberal end and Germany at the conservative end.

It was not certain what view of true and fair the French accounting regulators would take. The tradition in France was for uniform accounting where compliance with the regulations was seen as an over-riding consideration and the regulations were heavily oriented towards tax gathering. However, the accounting plan which existed prior to the Fourth Directive had been drawn up under economic conditions which no longer prevailed. Private enterprise in France had undergone radical re-structuring both economically and in its attitudes. It was aware of a need to communicate an economic view of the enterprise to shareholders, employees, and trading partners. The state wished to create and support companies which could compete on an international scale. The accounting profession wished to increase the use of judgement in French accounting and free it from the dominance of tax.

It appears that there was pressure for a change in attitudes to accounting measurement and disclosure well before the Fourth Directive was finally agreed. Some companies had already started producing alternative financial statements using US and other imported gaap. It seems probable that the Fourth Directive actually slowed down change in France, but also that when adopted the interpretation might be more towards the liberal one used by the British and less towards the conservative approach of the Germans.

The French regulations (the Nouveau Plan Comptable of 1982 and the accounting law of 1983) did not define the true and fair view. The existing requirement to provide sincere and regular accounts was retained and true and fair added to it. However, substantial efforts were made by those concerned with drafting the accounting plan to elaborate its import after it had been published and a clear message was given to the accounting constituency that the operation of the true and fair view involved considering the validity of the picture given by annual statements from an outsider's perspective.

The empirical evidence drawn from an analysis of a sample of published annual reports is that this message was well received in as far as two-thirds of the sample had re-appraised their 1983 data in the light of the new requirements. However, the second empirical exercise demonstrates that there remain differences of gaap between the French and British jurisdictions and that these will always generate different measurements of the same data.

Overall it appears that accounting measurement in France did move significantly through the implementation of the Fourth Directive and the true and fair view, but it is less certain whether this change was initiated by the harmonisation programme or would have taken place in any event, and even perhaps earlier than it did, because many groups with an interest in accounting wished to see change in this direction.

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APPENDIX I

Sample of French Corporate Reports

Non-food manufacturing companies

Aerospatiale
BIC
CFAO
CGE
Chausson
Dollfus-Mieg et Cie
Eternit
Groupe Prouvost
IMETAL
Lafarge Coppee
Legrand
Lille, Bonnieres et Colombes
Matra
Michelin
Peugeot
Poclain
Poliet
Radio Technique
Roussel Uclaf
Schneider
SNECMA
Sommer Allibert
Strafor
Thomson
TRT
Valeo
Vallorec
(27 companies)

Food manufacturing

Bongrain
Fromageries BEL
Generale Biscuit France
Grands Moulins de Paris
Groupe Lesieur
Groupe Pernod-Ricard
Guyomarc'h
Jacques Vabre
Landerneau
Moet-Hennessy
Olida Caby
Ortiz-Miko
Pomona
Saint Louis-Bouchon
Source Perrier
(15 companies)

Retailing

Au Printemps
Carrefour
Comptoirs Modernes
Darty
Euromarche
La Redoute
Nouvelles Galeries
Radar
(8 companies)

APPENDIX II

Case Study

Alpha Projects plc is a company which undertakes medium scale construction projects. During the financial year 19X1 the company went through substantial reorganisation following on events in the previous year. On the one hand the company was obliged to find new headquarters, and on the other it began a substantial overseas project.

Headquarters/financing

As regards the headquarters, the government announced in November 19X0 its intention of compulsorily purchasing the headquarters of the company (which comprised the main operational base for equipment etc.). The government was due to acquire the land in November 19X1 and the company therefore had one year to replace it. Alpha Projects decided to re-locate to an area where they would qualify for tax incentives and government grants. At the same time they had to modify their financial plans.

In December 19X0 the company took delivery of some plant which had been ordered earlier and paid £20,000 for it (it appears in the year-end balance sheet but was not depreciated during 19X0 because it was not brought into service until January). Given its financing needs the company negotiated a sale and leaseback of the plant with effect from 1st. January 19X1. The lessor bought the plant for £22,000 (the normal price) and entered into a four year lease. Rentals were £1,700 per quarter payable in advance (first payment 1st. January 19X1) and the implied interest rate was 3% per quarter. Normally the company would amortise such plant on a straight line basis over four years.

On 1st. March 19X1 Alpha Projects paid £80,000 for some freehold land and began construction of the new headquarters. The following payments were made in respect of the construction:

	£'000
31 March	25
31 May	50
30 June	40
31 August	30
31 October	35
31 December	20
	200

The new buildings came into service on 1st. December 19X1 and the company received a government grant of £20,000 against the cost at that time.
The company borrowed US$200,000 to finance the building; the interest was 14% pa and the Sterling amount received was £142,857 (US$1.00 = £0.7143); the money was received on 1st. March 19X1.
The old headquarters were duly purchased on 1st. December 19X1 and the government paid £125,000 to Alpha (the net book value at the end of 19X0 was £175,000.
In September 19X1 the company bought more plant which cost £12,000 and which came into service on 1st. October. Because of the new location the plant attracted a tax writing-down allowance of 50%; the usual depreciation rate within the company was 25% (straight line in both cases).

Overseas activity

During the year Alpha had won a contract for a project in Kuwait. The contract would bring in revenue of KD (Kuwaiti Dinars) 1.5m and costs were estimated by Alpha at KD 1.2m; the project would take approximately three years. Alpha decided that it was worth creating a Kuwaiti subsidiary to carry out the contract. The parent sent £50,000 (KD20,000) to subscribe for the shares on 1st. July 19X1. The new subsidiary, Alpha ME Ltd., also borrowed KD 50,000 from a local bank.
Alpha ME entered into contracts to rent offices and living accommodation, costing in total KD 10,000 a year. The company also leased some plant: it entered into a three year contract with a rental of

KD 11,665 per quarter, payable in advance and commencing on 1st. July 19X1 (the implied interest rate was 4.5% per quarter on a cost of KD 110,000). The machines were expected to have no further value after the three years.

By the end of 19X1 Alpha ME had had the following expenses:

	KD
Local staff	30,000
Materials	50,000
Rentals (lease etc.)	28,330
Administration cost	12,170
Bank interest	4,500
	125,000

Alpha ME had also paid £25,000 a month to Alpha in respect of fees etc. for expatriate staff and management services.

At the end of December the client had inspected the work in progress and indicated that all work done was satisfactory. The client had made two payments on account: KD 60,000 (1st. September) and KD 70,000 (1st. November).

The exchange rates during the period were:

	KD 1 = £
1st. July	2.50
1st. September	2.53
1st. November	2.57
31st. December	2.60
Average rate, Jul/Dec	2.55

Home activity

During 19X1 Alpha had traded successfully and had achieved the following results, before depreciation, interest, lease rentals, tax and the revenues from the subsidiary:

	£'000
Sales	1200
Materials	530
Salaries/Wages: construction	200
: administration	50
Electricity & Gas	20
Maintenance of plant	40
Administration expenses	75

Interest payments were:	30 June 19X1	\$9,350	(£ = \$1.35)
	31 December 19X1	\$14,000	(£ = \$1.30)

The writing-down allowances for tax purposes are 33.3% straight line for plant and 5% straight line on buildings. The company does not depreciate freehold land and uses the tax writing down rate for buildings.

At 31st. December 19X1 the value of stocks and work in progress was £30,000, debtors were £50,000 and trade creditors were £45,000.

The rate of Corporation Tax should be taken as 40%.

You are asked to use the above data to prepare an income statement and balance sheet for 19X1 for:

(i) Alpha Projects plc

(ii) Alpha ME Ltd.

(iii) Consolidated statements.

It may be that you will not find all the information that you need in the above details. Should that be the case you are asked to make any assumptions necessary but note them on the working papers.

The balance sheet of Alpha Projects plc at the beginning of 19X1 is attached.

Alpha projects plc

Balance Sheet as at 31 December 19X0

Fixed Assets				£'000
Tangible:	Freehold Land			125
	Premises	Cost	62.5	
		Depn.	(12.5)	50
	Plant	Cost	270.0	
		Depn	(120.0)	150
				325
Current Assets				
	Stock/Work in progress		20	
	Debtors		40	
	Cash at bank		15	
			75	
Creditors due in less than 1 year			(35)	
Net current assets				40
				365
Creditors due in more than 1 year				(100)
				265
Capital				
Ordinary shares				120
Reserves				145
				265