

Chapter 2

Development and Classification

Discussion Questions

1.
 - a) *Sources of finance.* Where capital markets/shareholders are the principal source of finance, accounting focuses on profitability, stewardship, and a fair presentation of results and financial position. There are high levels of disclosure in published financial statements. When banks are the principal source of finance, accounting tends to be conservative and disclosures are usually relatively low (banks have direct access to information). When governments are the principal source of finance, accounting is aimed at the information needs of government agencies such as tax collection, assembling macroeconomic statistics, or compliance with macroeconomic goals.
 - b) *Legal system.* Accounting in code law countries tends to be highly prescriptive, detailed, and procedural, designed to cover every possible circumstance. Accounting standards are a part of national laws. Accounting in common law countries is more adaptive and innovative and tends to allow more judgment to suit the circumstance. Accounting standards are set in the private sector.
 - c) *Taxation.* This tends to parallel the legal system. In common law countries (where accounting standards are set by the accounting profession), accounting and taxation are separate. In code law countries (where accounting standards are national laws), accounting and taxation are essentially the same.
 - d) *Political and economic ties.* Accounting technology and expertise is imported and exported based on the contacts that nations have with each other through commerce, conquest, etc.
 - e) *Inflation.* Historical cost accounting is the basis for initially recording transactions around the world. Inflation puts stress on the historical cost principle. Where inflation is high, accounting adjusts recorded amounts to reflect price level changes.
 - f) *Level of economic development.* This factor defines the difficulty and types of the accounting issues that are faced in a nation. Accounting is complex where business transactions are complex (in highly developed economies); it is simpler where transactions are simpler (in less developed countries).
 - g) *Education levels.* This factor defines the limits of accounting sophistication in a nation. Accounting cannot get very sophisticated where education levels are relatively low (unless the country imports accounting training or its citizens are sent elsewhere for it).
2. The text lists seven environmental circumstances asserted to have direct effects on accounting development. We judgmentally rank the list as follows:
 - a. Sources of finance
 - b. Legal system
 - c. Taxation
 - d. Political and economic ties
 - e. Education levels
 - f. Inflation
 - g. Level of economic development

Students may wish to alter this ranking and justify their own. It should also be pointed out that the rankings for certain countries may be quite different.

Capital markets as a source of finance are driving accounting development today. This phenomenon is the reason why the European Union decided to abandon its own effort at developing European accounting principles and require IFRS for EU listed companies. It is behind the convergence movement described in Chapter 8. The chapter argues that the fair presentation versus legal compliance classification describes accounting today better than the one based on legal system. This argument is consistent with sources of finance as the driver of accounting development today.

Level of economic development exerts only a moderate effect. This is because developing economies tend to import accounting technologies (and training) from developed countries. For example, many countries in emerging market economies are adapting sophisticated Western accounting systems in order to enhance their development efforts.

3. Culture underlies institutional and other arrangements in a nation that directly affect accounting development. Individualism, power distance, and uncertainty avoidance are likely to be the most important influences. Individualism, small power distance, and weak uncertainty avoidance tend to be correlated with and found in common law countries with fair presentation accounting. There is a strong accounting profession, accountants rely on professional judgment, and capital markets are the principal source of finance.

Collectivism, large power distance, and strong uncertainty avoidance tend to be correlated with and found in code law countries with legal compliance accounting. The profession is relatively weak - accounting is influenced by law, instead. Accounting is more conservative and prescriptive, and banks and governments are the principal sources of finance.

4. This question is controversial and there is no consensus of opinion at present. However, as noted in the answer to question 3, culture exerts a second-order effect on accounting. It underlies institutional and other arrangements in a nation that directly affect accounting development. We feel that economic and legal factors are more clearly linked to specific features of accounting, whereas cultural variables are linked to broader generalizations about accounting. Thus, we argue that economic and legal factors explain national differences in accounting practice better than culture.
5. Generally speaking, these patterns of accounting development are still valid today, but less so than in 1967. The descriptions of accounting in the chapter for the respective exemplar countries are broadly true. However, note that the Netherlands is really the only country that can be described by the microeconomic pattern. There are also only a few countries that follow the macroeconomic pattern. The independent discipline approach is not as ad hoc as it was in 1967. Most of these countries (in particular, the United Kingdom and United States) now have conceptual frameworks to guide accounting policy formulation. The uniform accounting approach is less relevant as more and more countries privatize their economies.

We expect these patterns to break down in the future as financial reporting converges around International Financial Reporting Standards. As discussed in this chapter, the trend is for fair presentation accounting at the consolidated financial statement level. The macroeconomic and the uniform approaches will persist in certain code law countries at the individual company financial statement level (for example, for tax collection purposes). The microeconomic and

independent discipline approaches have always been fair presentation oriented. So, they will likely disappear due to convergence, as discussed above.

6. Conservative measurements and secretive disclosures tend to be correlated. At the same time, less emphasis on conservative measurements and transparent disclosures also tend to be correlated. This is largely due to the principal source of finance in a country. Banks and governments are concerned about the safety net that conservatism affords; and because they tend to have direct access to information, public disclosure is less important. Capital markets demand a fair presentation of financial position and results of operations along with high levels of disclosure
7. Classifications are a way of viewing the world. They abstract from complexity and reveal fundamental characteristics that members of the group have in common and that distinguish the various groups from each other. Classifications provide the basic structure for understanding what is alike and what is different in accounting around the world. By identifying similarities and differences, our understanding of accounting systems is improved.
8. Judgmental classifications rely on knowledge, intuition and experience. Empirically derived classifications apply statistical methods to databases of accounting principles and practices around the world. This chapter discusses Mueller's four approaches in accounting development (1967), which is essentially a judgmental classification of accounting. The fair presentation versus legal compliance classification and classifications based on legal systems are also judgmental, though largely supported by empirical data.
9. The chapter discusses three major accounting classifications. The first is the one by Mueller (1967):
 - Macroeconomic approach, where accounting practice is designed to enhance macroeconomic goals;
 - Microeconomic approach, where accounting develops from the principles of microeconomics;
 - Independent discipline approach, where accounting develops from business practices based on judgment and trial-and-error; and
 - Uniform approach, where accounting is standardized so it can be used as a tool of administrative control by central government.

The second classification is the one based on legal systems, which closely parallels the third classification based on practice systems. Generally speaking, the features of common law accounting (legal system) are those described for fair presentation accounting (practice system). The features of code law accounting (legal system) are those described for legal compliance accounting (practice system).

Fair presentation (common law) emphasizes substance over form and is oriented toward the decision needs of external investors. Thus, it is capital markets oriented. Financial statements help investors judge managerial performance and predict future cash flows and profitability. Extensive disclosures provide additional relevant information for these purposes

Legal compliance (code law) accounting is designed to satisfy government-imposed requirements such as calculating taxable income or complying with the national government's macroeconomic plan. The income amount may also be the basis for dividends paid to shareholders and bonuses

paid to employees. Conservative measurements ensure that prudent amounts are distributed and smooth income brings stable tax, dividend and bonus payouts.

As noted above, fair presentation accounting is associated with common law countries, while legal compliance accounting is associated with code law countries. However, many companies from code law countries now follow International Financial Reporting Standards in their consolidated financial statements. IFRS are based on the principles of fair presentation.

10. The chapter contends that many accounting distinctions at the national level are becoming blurred because of global capital market pressures. An increasing number of companies are listing on multiple stock exchanges. This has pressured accounting policy makers around the world to harmonize (converge) reporting requirements. This has also pressured companies to devise financial reporting practices that satisfy multiple requirements and user groups. At the same time, some code law countries where accounting is aimed at legal compliance have dual reporting. Consolidated financial statements are aimed at fair presentation (IFRS), while individual company financial statements continue to be aimed at legal compliance.
11. Our preference for classifying based on fair presentation versus legal compliance over legal system follows from the answer to question 10. Many companies from code law countries now prepare two sets of financial statements. Consolidated financial statements follow fair presentation principles, while individual company accounts follow legal compliance principles. Listed companies from the European Union now follow International Financial Reporting Standards in their consolidated financial statements. IFRS are based on fair presentation principles.
12. In your authors' opinion, the prospects for the harmonization of national systems of accounting is low. As the chapter demonstrates, accounting satisfies the information needs of its users and develops in response environmental circumstances. Unless these forces converge, there is little reason to expect accounting to converge. Also, taxation is a fundamental influence on accounting in many countries - it is the reason accounting exists in the first place. Unless governments are willing to relinquish their sovereignty over such matters, national accounting systems cannot be harmonized. At the national level, accounting systems are too entrenched.

However, the story is different at the transnational (or international) level for consolidated financial statements. Convergence is occurring here, driven by the globalization of capital markets. Companies now seek capital from around the world and must appeal to the information needs of a worldwide investor group. The type of information these investors seek is similar, regardless of where they reside. This same force drove the European Union requirement for listed companies to comply with International Financial Reporting Standards starting in 2005. This means dual reporting for many companies, especially those from European countries where accounting is legalistic and tax-driven. Local financial statements will be prepared in compliance with local laws and accounting standards, but secondary financial statements will be prepared for the worldwide investor group. Consolidated financial reporting is converging onto fair presentation based on IFRS.

Exercises

1. a. The dominant factor influencing accounting development in Taiwan is political and economic ties, namely those with the United States since the 1950s. In 1949, defeated by the Communists, Chiang Kai-shek fled to Taiwan and set up a provisional government there. Taiwan soon began receiving substantial U.S. economic aid to prevent the further

spread of Communism. Taiwan is a dynamic capitalist economy and the United States is the country's largest trading partner. Taiwan is an economic power that is a leading producer of high-technology goods. Services make up more than two-thirds of GDP. Nevertheless, small, family owned businesses are the basis for the economy. Taiwan has a credit-based, rather than capital markets-based financial system. Its (Germanic) code law legal system dates from the years (1895 – 1945) when Taiwan was a Japanese colony. Given the influence of the United States, it can be expected that taxation will not directly impact financial reporting (despite the code law legal system). Additional development factors are a low level of inflation and high education level (literacy rate approaching 100 percent).

- b. Overall, one would expect accounting to resemble U.S. accounting, emphasizing a fair presentation and full disclosure as opposed to compliance with legal requirements. Accountants can be expected to exercise judgment and not merely follow the rules or the tax laws.
 - c. The above prediction is accurate according to the fifth edition of this textbook (Prentice Hall, 2005) and Ronald Ma, ed., *Financial Reporting in the Pacific Asia Region*, Singapore: World Scientific Publishing (1997). Accounting in Taiwan is largely based on U.S. accounting. Accounting standard-setting is a private sector activity, modeled after the U.S. Financial Accounting Standards Board.
2. Gambia and India (both former British colonies) have common law legal systems, while Belgium, Czech Republic, Mexico, Senegal (former French colony), and Taiwan have code law legal systems. China's legal system is not derived from code law, but more closely resembles code law than common law. Gambia and India have fair presentation accounting because of the British colonial influence and Senegal has legal compliance accounting because of French colonial influence. As members of the European Union, both Belgium and the Czech Republic require International Financial Reporting Standards (fair presentation) for consolidated financial statements. China is also basing its reporting standards on IFRS. Because of U.S. influence, Mexico and Taiwan have fair presentation accounting.
3. For each of the three comparative accounting development patterns to be identified, four U.S. examples are listed. (Students were asked to identify two examples each.)
 - a. The macro-economic pattern
 1. Accounting for investment tax credits.
 2. Disclosure of corporate social responsibility activities.
 3. Selected application of accelerated depreciation methods.
 4. Disclosure of oil and gas reserves by oil companies.
 - b. The micro-economic pattern
 1. Mark to market accounting for financial instruments.
 2. Segmental financial reporting according to *FASB Statement No. 131*.
 3. Pension accounting and disclosure of pension liabilities.
 4. Industry-specific accounting, e.g., for banks, insurance companies, public utilities, railroads.
 - c. The independent discipline approach
 1. The realization principle.
 2. Reporting of business income as a residual between realized revenues and recognized expenses for a given period.

3. Classifying assets and liabilities as current and noncurrent on the balance sheet.
 4. Foreign exchange translation according to *FASB Statement No. 52*.
4. The answer to the question depends on the countries and the companies chosen. In general, one would expect students to discuss measurement and disclosure issues. Accounting in common law countries is based on fairness and substance over form, whereas in code law countries it stresses legal compliance, including tax laws. Thus, accounting and tax are separate in the former, but the same in the latter. Specific practices where this distinction is most obvious is in accounting for depreciation, leases, pensions, and deferred income taxes. Accounting in code law countries tends to be more conservative and it is common to see discretionary reserves used to smooth income. Of course, these are broad generalizations.

Disclosure involves the amount and type. Generally, higher levels are found in common law countries and lower levels are found in code law countries. It is difficult to generalize about disclosure types. Students ought to compare such issues as disclosure of accounting policies, segment information, contingent liabilities, and social and nonfinancial matters.

This exercise also lends itself to a group project where one student takes one company and another student takes the other. The length of the answer will vary depending on how in-depth the instructor wants to be.

One reason why the similarities and differences may not conform to expectations is due to the type of company chosen. Large multinational corporations, especially from code law countries, often have different reporting than their domestic counterparts. Their disclosure levels are more extensive and they may not use home GAAP. All EU listed companies must now prepare consolidated statements using IFRS. It is useful to compare the two companies chosen on the basis of size, extent of multinational operations, and international listing status. Also note that the Netherlands has always followed “common law” accounting (i.e., fair presentation) even though it is a code law country.

5. At the time of writing, the 2005 annual report was the most recent one available. The stock exchanges with the most foreign listed companies were New York (452), London (334), Nasdaq (332), Euronext (293), and Luxembourg (206). The attraction of New York, London, and Nasdaq for foreign companies is that these are the major capital markets in the world. Euronext and Luxembourg attract many European companies.

The stock exchanges with the highest proportion of foreign to total listed companies were Luxembourg (84%), Bermuda (66%), Mexico (54%), Swiss (29%), and Euronext (23%). As noted, Luxembourg and Euronext attract many European companies. The Swiss Exchange does as well. Bermuda is known as a financial center with easy laws, which may explain its high proportion. The Mexican Exchange attracts companies from Central and South America.

6. Arguably the most serious obstacle to accounting harmonization in the EU is that common and code law countries are both represented. This determines how standards are set and the basic orientation of accounting. However, differences can be noted in every developmental factor discussed in the chapter, including the cultural dimension. Nevertheless, the economic and political ties among the member countries are a dominant force supporting EU harmonization — the group is committed to economic integration, including a single currency, the euro. EU countries are converging on fair presentation accounting for consolidated financial statements, propelled by market forces such as these.

7. For the ten countries joining the EU in 2004 and the two countries joining in 2007, the level of economic development and the fact that they lack developed capital markets (system of finance) is likely to be the most serious obstacles for achieving accounting harmonization with the rest of the EU. Most of these countries are still expanding their market economies from ones that were centrally planned. Accounting expertise is also still being developed.
8.
 - a. The individualism scores are: China (20), the Czech Republic (58), France (71), Germany (67), India (48), Japan (46), Mexico (30), the Netherlands (80), the United Kingdom (89), and the United States (91).
 - b. Countries with high individualism scores are France, Germany, the Netherlands, United Kingdom, and United States. Countries with medium individualism scores are Czech Republic, India, and Japan. Countries with low individualism scores are China and Mexico.
 - c. According to Gray, high individualism is associated with professionalism, flexibility, optimism, and transparency. (Note to instructors: After reading Chapters 3 and 4, students will recognize that these characterize Dutch, U.K. and U.S. accounting, but not French and German accounting. [Note also that the Netherlands, U.K., and U.S. have the highest individualism scores of all 10 countries.]) According to Gray, low individualism is associated with statutory control, uniformity, conservatism, and secrecy. (Note to instructors: After reading Chapters 3 and 4, students will recognize that only statutory control and (to some extent) secrecy is associated with China, while only secrecy is associated with Mexico. Gray's prediction for these two countries is not very good.) Medium individualism scores presumably predict accounting values 'in the middle'. (Note to instructors: After reading Chapters 3 and 4, students will recognize that the Czech Republic, India, and Japan do not really fall 'in the middle' on Gray's accounting values. The Czech Republic and Japan generally reflect the accounting values of statutory control, uniformity, conservatism, and secrecy. India is generally associated with professionalism, flexibility, optimism, and transparency.)
9.
 - a. The uncertainty avoidance scores are: China (30), the Czech Republic (74), France (86), Germany (65), India (40), Japan (92), Mexico (82), the Netherlands (53), the United Kingdom (35), and the United States (46).
 - b. Countries with high uncertainty avoidance scores are the Czech Republic, France, Germany, Japan, and Mexico. Countries with medium uncertainty avoidance scores are India, the Netherlands, and the United States. Countries with low uncertainty avoidance scores are China and the United Kingdom.
 - c. According to Gray, high uncertainty avoidance is associated with statutory control, uniformity, conservatism, and secrecy. (Note to instructors: After reading Chapters 3 and 4, students will recognize that Gray's prediction describes accounting well for the Czech Republic, France, and Germany. The prediction describes Japan before the "Big Bang", but less so now. Except for secrecy, the prediction does not describe accounting values in Mexico.) According to Gray, low uncertainty avoidance is associated with professionalism, flexibility, optimism, and transparency. (Note to instructors: After reading Chapters 3 and 4, students will recognize that these are features of U.K. accounting, but not China.) Medium uncertainty avoidance scores presumably predict accounting values 'in the middle'. (Note to instructors: After reading Chapters 3 and 4, students will recognize that India, the Netherlands, and the United States have similar

accounting values to the United Kingdom. Gray's prediction for these three countries is not very good.)

- d. The only consistent prediction between Exercise 8 (individualism) and Exercise 9 (uncertainty avoidance) is that for the United Kingdom. Gray's model linking culture and accounting is valid for the U.K. The model's predictions are exactly opposite for China, but in neither case does it predict China's accounting values very well. Based on individualism, the model does a "good job" predicting the accounting values in the Netherlands, U.K., and U.S., but a "poor or moderate" job predicting accounting values in the other seven countries. Based on uncertainty avoidance, the model does a "good job" predicting accounting values in the Czech Republic, France, Germany, Japan, and U.K., but a "poor or moderate" job prediction accounting in the other five countries. Overall, one would have to conclude that the success of Gray's model linking culture and accounting is modest at best.
10. The following table summarizes the use of IFRS by domestic listed companies in the 10 countries identified, according to the IAS Plus Web site at the time of writing:

	<u>Not permitted</u>	<u>Permitted</u>	<u>Required for Some</u>	<u>Required for All</u>
China			X	
Czech Republic				X
France				X
Germany				X
India	X			
Japan	X			
Mexico	X			
Netherlands				X
United Kingdom				X
United States	X			

The five countries of the European Union require their domestic listed companies to use IFRS. This EU requirement is discussed in the chapter. India, Japan, Mexico, and the United States require their domestic listed companies to use national GAAP, not IFRS. The implication is that these four countries believe that their own national standards better reflect financial reporting to various constituencies than do IFRS. (However, Chapter 4 discusses that these four countries are converging their national GAAP with IFRS.) China requires some domestic listed companies to use IFRS. The inference is that IFRS are relevant for some but not all domestic Chinese companies. (Chapter 4 notes that Chinese companies issuing so-called B-shares (shares to foreign investors) must prepare English language financial statements. One might infer that companies with B-shares would also be required to use IFRS. Chapter 4 also discusses that China is converging national GAAP to IFRS.)

11. France: With banks and government as the main sources of finance, we can expect conservative and uniform measurements. With code law legal system, the focus is on complying with the law. The link to taxation means that measurements are also tax-oriented. Political and economic ties with the rest of Europe suggest that French accounting may influence and be influenced by other European countries. Low inflation indicates a low likelihood of inflation

adjustments. The levels of economic development and education suggest sophisticated accounting.

India: With the government and stock market as the main sources of finance, we can expect a mixed (and inconsistent) orientation – uniformity but also fair presentation. The common law legal system and separation between tax and financial accounting indicate fair presentation accounting. The political and economic ties to the U.K. and U.S.A. also suggest fair presentation accounting. (Economic ties to China are probably unimportant in describing Indian accounting.) Low inflation suggests a low likelihood of inflation adjustments. The levels of economic development and education suggest less complex accounting standards and practices.

Japan: With banks as the main source of finance, we can expect conservative accounting measurements. With the code law legal system, focus is on complying with the law. The link to taxation means that measurements are also tax-oriented. Political and economic ties to the U.S.A. indicate some U.S. influence on Japanese accounting. (Economic ties to China are probably unimportant in describing Japanese accounting.) Low inflation suggests a low likelihood of inflation adjustments. The levels of economic development and education suggest sophisticated accounting.

United Kingdom: With the stock market as the main source of finance, we can expect fair presentation accounting. Fair presentation accounting can also be expected because the U.K. has common law, and taxation and accounting are separate (i.e., not linked). Political and economic ties to the U.S.A. and Europe suggest accounting influence is felt to and from both areas. Low inflation indicates a low likelihood of inflation adjustments. The levels of economic development and education suggest sophisticated accounting.

United States: With the stock market as the main source of finance, we can expect fair presentation accounting. Fair presentation accounting can also be expected because the U.S.A. has common law, and taxation and accounting are separate (i.e., not linked). Political and economic ties to the Canada and Mexico most likely mean that these two countries are influenced by the U.S.A., rather than the other way around. Low inflation indicates a low likelihood of inflation adjustments. The levels of economic development and education suggest sophisticated accounting.

12. The irreversible globalization of capital markets and increasing trend of multiple stock exchange listings is causing more and more companies to adopt fair presentation accounting for their worldwide audience. The chapter notes how accounting distinctions are becoming blurred. Chapter 3 also notes how Germany and Chapter 4 shows how Japan have established standard setting organizations for the purpose of adopting reporting standards for consolidated financial statements that are in line with International Financial Reporting Standards. Standard setters in the United States, Canada, Australia, and many other countries are committed to converging their financial reporting with IFRS. Finally, the European Union now requires EU-listed companies to follow IFRS in their consolidated financial statements from 2005 on.

Thus, we believe that the two-way split proposed in the chapter (fair presentation versus legal compliance) will be even more significant than it is now. Countries already oriented toward fair presentation (such as Australia, Canada, the Netherlands, United Kingdom, United States) will converge around International Financial Reporting Standards. Regardless of the home country of the company concerned, consolidated financial statements will be prepared on a fair presentation/full disclosure basis, as can be seen in the EU 2005 requirement. Countries that

traditionally stressed legal compliance accounting, such as France and Germany, will continue to use this type of accounting for individual company financial statements. In other words, there will be dual reporting in these countries — fair presentation accounting in consolidated financial statements and legal compliance accounting in individual company financial statements.

Case 2-1

Are Classifications Of Accounting Outmoded?

1. The comments by Mr. Cairns are inconsistent with ideas put forth in this chapter as well as most international accounting observers. While it is true that classifications are simplifications, they are hardly simplistic. For the most part, we believe that accounting practice and standards still retain distinctive national characteristics. The classifications in this chapter help one get a handle on the essential points of difference and similarity in the observable features of accounting around the world. We therefore disagree with Cairns's assertions contained in the quote.
2. However, it does seem that for a select segment of the corporate world, the classifications discussed in the chapter are less (or ir-) relevant. World class companies, multinationals with multiple share listings around the world, are increasingly tailoring their financial reports for a sophisticated, worldwide user group that has essentially similar demands for information. It is the pursuit of international capital that seems to be driving this phenomenon. Thus, one should distinguish financial reporting at the domestic level from that at the international level, especially for companies from countries such as Japan, Germany, Sweden, and Switzerland that have a legalistic/tax compliance orientation of accounting at the national level. There is truth in Cairns's comments for this group of companies. (Given Mr. Cairns's association with the IASC, perhaps it was this group of companies that he was implicitly referring to.) Besides the drive for international capital, changes in information technology (e.g., the Internet) that allow instantaneous access to information and 24-hour trading in securities are also driving this result. And, as Mr. Cairns notes, standard setters from around the world are increasingly talking to one another in an attempt to develop compatible standards.

Note: The instructor may want to refer to Christopher Nobes, The Future Shape of Harmonization: Some Replies, *European Accounting Review*, Vol. 7. No. 2 1998, pp. 323-333. Nobes refutes several of Cairns's points.

Case 2-2**Volkswagen Group**

1. Germany is a code law country with legal compliance accounting. Thus, German accounting may be characterized as tax-determined, with conservative measurements and income smoothing. Legal form dominates economic substance. Banks are the primary source of finance and it is likely that they prefer the safety net that conservative measurements and stable income affords. Tax authorities also prefer these features of accounting. As a code law country, accounting requirements are incorporated into law.
2. Conservative measurements are most obvious in the different balances for capital and reserves according to German Commercial Code (€9,811) versus IAS (€20, 918). Conservative measurements are also illustrated by the non-capitalization of development costs, inventory overhead, and leases; and the valuation of derivative financial instruments at cost rather than fair value. Provisions (€2,022) are an income smoothing device. Income is also smoother when derivatives are valued at cost rather than fair value. Tax-based accounting is illustrated by depreciation (€3,483) and the fact that deferred taxes (€1,345) are not provided for (under German accounting).
3. Companies from code law countries are increasingly adopting fair presentation accounting in their consolidated financial statements. Volkswagen's adoption of IAS (now IFRS) in 2001 illustrates this trend. Your authors argue that a classification based on fair presentation versus legal compliance better reflects accounting in the world today than a classification based on legal system (code law versus common law). Volkswagen's adoption of IAS supports this position. Volkswagen, a German company, began using fair presentation principles (i.e., IAS/IFRS) in its consolidated statements, not legal compliance principles as under German Commercial Code.