2003

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Cover Page Footnote
International Law; Commercial Law; Law

This article is available in North Carolina Journal of International Law: https://scholarship.law.unc.edu/ncilj/vol28/iss4/3
Comparative Corporate Governance: Generally Accepted Accounting Principles v. International Accounting Standards?

Bernhard Grossfeld

I. Wider Perspectives

Since Enron and "Enronitis," the competition between the American Generally Accepted Accounting Principles (GAAP) and the more European inspired International Accounting Standards (IAS) has taken up new steam. But I do not want to discuss these topics in isolation, as if accounting and accounting alone could save the financial markets by restoring investors' trust in corporate financial statements. Enron alone might be just a "nine-day" talk. Therefore, I will put the questions into an older and wider comparative law context by discussing them within the framework of corporate governance. Comparative law might be "in a state of disorientation." But that does not change the fact that "corporate lawyers now need to be comparative lawyers," in view of cyberspace and cyberspace business method patents that

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* Professor of Law and Director of the Institute for International Business Law, Muenster University, Germany.


6 See Bernhard Grossfeld, Cyber Corporation Law: Comparative Legal Semiotics/Comparative Legal Logistics, 35 INT’L L. 1405 (2001); Asaal Siddiqui,
have reached the world of accounting. My focus is that lawyers, as lawyers, can and should take more interest in accounting. The result is good for both accounting and for lawyers. At the very least, attorneys should cultivate their ability to ask "stupid" questions.

II. Corporate Governance

The reference to corporate governance aspects barely needs an explanation. "Corporate governance" comprises a broad spectrum of individual issues relating to corporation and capital market law; "[it is] geared towards corporate management and control in order to achieve long-term values." Transparency, independent control, and prospective information are the main instruments to be relied on. The term "prospective information" makes clear that accounting is a major pillar of this policy. The Sarbanes-Oxley Act, the new U.S. law on corporate governance, added a new twist to this "staple food." It federalizes state corporation law at a level never envisioned before.

Unfortunately, however, accounting as the decisive part of corporate governance is a new idea for most lawyers and many law schools. Only very few see expertise in accounting as an
important skill for lawyers. The overwhelming majority leaves it to “number crunchers,” thus forgetting the strong influence of mathematical reasoning and “number crunching” on our legal culture. Arabic numbers and double accounting came as partners into Europe; they created the algebraic mind that stands behind the rational approach in Western law. Notwithstanding these vital traditions, many academics dismiss accounting as an inferior craft, not up to the lofty ideals of “justice for all.”

Under the influence of law and economics, some even look upon accounting as a set of unreliable conventions that efficient markets do not need to arrive at real values. However, Enron and WorldCom have taught us that markets require trustworthy information through a well-defined semiotic system of letters and numbers. Law is an instrument of social credit that can communicate values, decrease transaction costs, and contain consequences. It is all about insuring a mutual identity between the appearance and reality. Though largely formed in words, law is the natural enemy of a “words, words, words,” or “air kisses” approach.

III. Absence of Expertise

Today, corporate disclosure and corporate accountability are in everybody’s mouth. But the question is where was this expertise when collapsing firms and collapsing markets caused a crisis of our corporate governance concepts? The answer is simple. It was not there when it was needed; it did not even touch accounting. The lawyer’s tainted, shareholder-oriented model did not care to control or to follow up on the basis of information and the “cash flow of justice.”

This failure might be explained by a concept that is too narrow to grasp the corporate reality. This reality is not shareholders; it is

2001).

15 See Cunningham, supra note 1, at 1441.
16 See id. at 1451–53.
18 See Alexander Murray, Reason and Society in the Middle Ages (1978).
19 See Cunningham, supra note 1, at 1441.
20 See id. at 1421–22.
the power of an institution that is relieved from the tragic fate of natural persons. Corporations do not die a natural death; they are immortal, and they never pay estate taxes. They attract into their coffers and are driven by the power of interests and compound interests for a period of time beyond a human life. J. P. Morgan incorporated his bank with the aim "to perpetuate the business." Brandeis’s vision of the "Frankenstein monster" is ever present.

Power does not care for ethics. Super-individual powers, such as corporations, can only be controlled effectively by super-individual countervailing powers and reactions that are statistically relevant. In our market-oriented economies, only financial markets accumulate the energy to trigger adequate reactions. They become public institutions of corporate governance. These financial markets in turn need proper information through accounting, lest control not turn into lottery. Thus, immortality and accounting belong together. It is no small wonder that academic legal papers that leave out immortality also forget accounting.

The same is true when discussing Delaware law and all kinds of great ideas surrounding that subject, they always miss accounting and thereby miss the point. Delaware again and again does not meet the central issues of corporate governance anymore—the discussion is academic. The imbalance is all the more disturbing as the literature about Delaware’s now reaches gigantic proportions, spilling over into cross-border insolvencies. As Robert Daines tells us, “more than 20,000 law review articles discussed Delaware law, roughly two pages of law review text for every person in Delaware!” We are happy to hear that this wonder of democratic majority rule does indeed improve firm value, although scepticism remains. We are also tempted to

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25 Robert Daines, Does Delaware Law Improve Firm Value?, 62 J. FIN. ECON. 525
believe that market forces provided for the rest, so that Delaware leads the “race to the top.” Unfortunately, accounting is rarely part of it, and even more unfortunate, the brave world top did not prevent Enron, WorldCom, and Xerox. Were they on top?

IV. Lawyers as Salvation?

Given the loss of reputation for accountants after the demise of Arthur Andersen, we might propose lawyers as salvation for fixing the numbers problems. But this is not easy given lawyers’ legal history or irresponsible lethargy. Remember the stories surrounding the collapse of many savings and loan associations as described by Judge Sporkin in the Lincoln Savings Bank case of 1990. Enron looks like old stuff against this background. Let me quote from Judge Sporkin’s language dealing with the “skulduggery” in that case. He starts with “arcane accounting provisions” and the “sorry state of the system of accounting” in the United States and stresses the following point:

What it is hoped the accounting profession will learn from this case is that an accountant must not blindly apply accounting conventions without reviewing the transaction to determine whether it makes any economic sense and without first finding that the transaction is realistic and makes any economic substance that would justify the booking of the transaction that occurred. Moreover, they should be particularly skeptical of any transaction where the audit rail is woefully lacking and the audited entity has failed to comply with the record keeping requirements established by a federal regulatory body. Of course, the accountants might say they did not have access to the facts that either the Bank Board or the Court had, and it is thus unfair to criticize them for any mistake they have made. The


28 Id. at 911.

29 Id. at 912.

30 Id.
fact is the accountants have been aware of the true facts for many months now and have taken no steps to dissociate themselves from the transaction, and indeed have attempted to rationalize before this Court the propriety of the actions they took in allowing the transaction to be booked as it was.31

"Accountants [and lawyers] must be particularly skeptical where a transaction has little or no economic substance. This is so despite the fact that the transaction might technically meet the GAAP standards."32 This leads to the final blow:

There are other unanswered questions presented by this case. Keating [the chairman and chief executive officer] testified that he was so bent on doing the ‘right thing’ that he surrounded himself with literally scores of accountants and lawyers to make sure all the transactions were legal. The questions that must be asked are: Where were these professionals, a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated? Why didn’t any of them speak up or dissociate themselves from the transactions? Where also were the outside accountants and attorneys when these transactions were effectuated?

What is difficult to understand is that with all the professional talent involved (both accounting and legal), why at least one professional would not have blown the whistle to stop the overreaching that took place in this case?33

As in Lincoln Savings, so in Enron and WorldCom, there were plenty of lawyers around giving their blessings to every single step, but we might take as an excuse that they did not know what was going on. Our traditional thinking as lawyer might have made them awe-inspired towards the magical power of accountants. Most of us believe that accountants know it when they make a treasure box from an overflowing and disorderly kept file store. Accountants know by definition! Lawyers then see themselves in the position of seam-stressing or tailoring beautiful looking legal garments. Clothes make fine statements!

31 Id. at 913.
32 Id. at 914 n.17.
33 Id. at 919.
It occurs to me now
that all these years
I have been
the idiot pupil
of a practical joker.\(^\text{34}\)

What we need are lawyers who have the courage to use the wonderful American expressions “sounds good” or “wait and see.” We should not do away with our senses in matters of accounting. Instead, we should even better try to acquire some expertise. Let’s turn to this expertise.

V. Complexity

The Generally Accepted Accounting Principles seem to have run out of control by frenzy for details and by paper overload. We are lost in papers. Just look into some of our offices or into the halls of some law schools. The amount makes the poison: “Over-information kills information.\(^\text{35}\) The Securities and Exchange Commission, following Sarbanes-Oxley, now often quotes the “Paperwork Reduction Act of 1995,”\(^\text{36}\) but so far it is more an empty hope than anything else. Let’s have a look into the standards overload.

In Bily v. Arthur Young & Co.\(^\text{37}\) the Supreme Court of California said:

Like the GAAS (Generally Accepted Accounting Standards) the GAAP are an amalgam of statements issued by the AICPA (American Institute of Certified Public Accountants) through the successive groups it has established to promulgate accounting principles: The Committee on Accounting Procedure, the Accounting Principles Board, and the Financial Accounting Standards Board. Like the GAAS, GAAP include broad statements of accounting principles amounting to aspirational norms as well as more specific guidelines and illustrations. The lack of an official compilation allows for some debate of


\(^{35}\) Marguerite Most, Electronic Journals in the Academic Law Library: Law Reviews and Beyond, 21 Legal Reference Services Quarterly 189 (2002).


whether particular announcements are encompassed within GAAP.... One standard book purporting to comprehensively restate GAAP includes 90 major sections and more than 500 pages.... In addition to or in place of the standardized statements in an audit report, the auditing CPA [Certified Public Accountant] firm may also qualify its opinion, noting exceptions or matters in the financial statements not in conformity with GAAP or significant uncertainties which might affect a fair value evaluation of the statement.38

In Wiley GAAP 2000, the list of “Authoritative Statements” covers 39.5 pages.39 But the belief in sheer quantity of letters continues to exist—safety in numbers as it looks appropriate for accountants—for “a reduction in standards could ultimately reduce the quality of financial reporting.”40 As an observer from abroad, I do not criticise this approach, for we are not that much better off in Europe. It reflects the dynamic varieties of American life, but is also part of the social costs for the race to Delaware, be it to the top or to the bottom. There is nothing like a free breakfast.

VI. Gone with the Wind

This race to Delaware has changed the character of corporation law from mainly compulsory to often-optional rules. Entrepreneurs are free to customize the firm’s governance arrangements and shareholders’ rights. We are told that corporate law as such probably does not matter,41 neither for shareholders and stakeholders, nor for the creators of accounting principles. Is this true? Just consider the duplicity. Dependant directors easily issue and grant stock options and then hide them in obscure notes which no foreigner ever reads. Is this shareowner value or short-term chance for the beneficiaries? How is it with creditors? Delaware has become the top venue for corporate insolvency proceedings under Chapter 11 of the U.S. Bankruptcy Code.42 As the federal courts, they offer flexible chances for management that

38 Id. at 750–51.
40 FRANKLIN A. GEVURTZ, CORPORATE LAW ANTHOLOGY 48 (1997).
41 Cf. id. at 48.
prefers to stay in office. But the highly praised liberal "genius" has gone with the wind. It has gone with the wind of Enron, WorldCom, Xerox, and Arthur Andersen. Small wonder the Generally Accepted Accounting Principles lack the aesthetics that induce people to internalise law. So far we were made to believe that the expertise of accountants, the priests with the Holy Grail of numbers, managed to cope with the lack of appearance and with the chaos as a kind of "invisible hand". They were trusted to know the holy name. But the demise of Arthur Anderson, once upon a time the herald of professional ethics, destroyed this naivete. When the curtain in the temple came down, there was little left to be seen.

VII. Cash Flow of Justice

At this point we may be able to answer the question asked by Judge Sporkin, "How could it happen?" One reason at least is complexity and the loose definition of what belongs to the Generally Accepted Accounting Principles. The ever-present explanation is that this is a complex professional judgment. Complexity affords professional immunity. We are lost in letters, the interactions of which follow no clear patterns. Already from statistical probabilities we might assume that in a heap of unrelated words, the combinatorial power of the human mind will find every answer. "Our nature is an illimitable space through which the intelligence moves without coming to an end." This works to the advantage of accountants, but also to their disadvantage. It is a trap.

This is particularly true with the literal space. Words can much more easily be glued together than facts. Our word-and-letter-driven education techniques, teach words almost entirely from words and use libraries as cathedrals. Modern philosophical

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47 Wallace Stevens, The Figure of Youth as Virile Poet, in THE NECESSARY ANGEL 39-67 (Faber & Faber 1960).
oracles tell us that there is "nothing outside the text," that "text is self referential."\textsuperscript{48} Wittgenstein's words that "the limits of the language (the language which I understand) mean the limits of my world"\textsuperscript{49} are nonsense. They imprison sufficiently trained minds that get mystified by the "spell of language."\textsuperscript{50} They lose touch with reality. We are educating half-brained accountants and lawyers, discriminating against fact- and metaphor-oriented minds. This creates a perfect breeding ground for verbosity puzzles without any international perspective.\textsuperscript{51} Where every word might fit, other incentives will affect the choice between alternatives. Let us call them the "cash flow of justice".

Is this not just a problem of Enron, Arthur Anderson, or KPMG? It is so alleviating to point our fingers at bad guys. Probably it is only good luck, by hindsight, that we did not get the job. But where were the ethics committees of the profession, the high quality lobbyists after Lincoln Savings Bank\textsuperscript{52} and before Enron? Lawyers and law schools peddled along the old lines and missed their responsibility to take care of the future and to be critical companions of our students on their way into the world to come.

All that could not have happened without the regulatory rollbacks and changes in accounting rules that helped to account for anticipating revenue as income on long-term contracts as if the cash were coming in immediately (the Xerox\textsuperscript{53} saga). The underlying ideology and the culture of looking only at the short-term were the driving forces. In accounting, it all comes down to timing. But who has thought about time? Quickly bulging bottom lines were the orders of the Securities and Account Commission

\textsuperscript{49} LUDWIG WITTGENSTEIN, TRACTATUS LOGICO-PHILOSOPHICUS 151 (Harcourt Brace & Co. 1933).
\textsuperscript{50} See THOMAS G. PAVEL, THE FEUD OF LANGUAGE (Blackwell Publishers 1992).
\textsuperscript{51} Jack Hiller & Bernhard Grossfeld, Comparative Legal Semiotics and the Divided Mind: Are We Producing Half-Brained Lawyers, 50 AM. J. COMP. L. 175 (2002).
and of the Federal Accounting Standards Board. What looked like
debt or round-trip trades under conservative standards was now
booked as cash flow from operations. The Generally Accepted
Accounting Standards became an instrument to inflate stock value
and accountants rubber stamped it. No “[g]lory! Glory!
Hallelujah!”

“Too many examples of ‘creative accounting,’ all of which
were prepared in the U.S. in accord with GAAP, all met the
attestation of requirements of auditors.” Picking out the
problems of individual companies, accountants, and lawyers
obscures the intrinsic weakness of our craft and thereby obscures
the larger lessons. When a big plane goes down, it is not because
of one engine or the failure of one part of the electrical system.
Usually, there is a multiplicity of failures and they tend to cascade.

VIII. Competing Accounting Sets

From a comparative law point of view, we have to deal with
two competing sets of standards—the Generally Accepted
Accounting Principles and the International Accounting
Standards. Both are fiercely supported as being superior over
each other. The United States praises its product, applauded by
the Securities and Exchange Commission, not just as quality but as
high quality accounting. That aroused my suspicion even before
Enron. Are strong words just a cover up? The European Union
also proposes the International Accounting Standards with some
aplomb. It is pressing her chances with International Financial
Reporting Standards (IFRS) against critics. These standards

54 Paul Beckett et al., *How Energy-Trading Boom Went Bust*, WALL ST. J., Dec. 31,


56 Geoffrey George, *Accounting, Auditing and Auditors—What is to be done?*, 14

57 For a general discussion of normative competition, see Hannah L. Buxbaum,
*Conflict of Economic Laws: From Sovereignty to Substance*, 42 VA. J. INT’L L. 931
(2002).

58 See, e.g., Donald A. Schwartz, *Comments in Response to SEC Concept Release:

59 See, e.g., Council Regulation 1606/2002 on Application of International
Accounting Standards, 2002 O.J. (L 243) 1, para. (2), (5) [hereinafter EC Regulation].
should dominate the European scene from 2005 on for consolidated accounts of publicly traded corporations.\textsuperscript{61}

I do not want to repeat the differences between these two sets of standards as I have done recently in the American Journal of Comparative Law.\textsuperscript{62} At first glance, the answer about what is better is riddled with difficulties. The International Accounting Standards have their testing period still before them and they might be better off due to a more skeptical European approach towards "words, words, words" and "documents, documents, documents." But doubts persist even here. The complexity makes an in-depth comparison practically impossible. It reminds me of the question whether the French Civil Code is better than the German Civil Code or whether American common law is better than English common law (if there still is a common law\textsuperscript{63} or even an "Anglo-American" corporation law\textsuperscript{64}). As with Codes, so it is with Principles and Standards. We find similar origins but different locations. However, when "location, location, location" is the core of business, the same might be true for accounting.

\section*{IX. Some History}

Here are just some repetitious remarks. Historically, both sets of standards have the same roots.\textsuperscript{65} Thus, at first glance, they look like a prime and easy object for comparative law.\textsuperscript{66} The immigration of the Arabic numeral into Europe through Sicily and Spain from the end of the tenth century onward, which was promoted by Pope Sylvester II and the German emperors, brought about a change in business patterns and legal reasoning.\textsuperscript{67} A new

\begin{footnotesize}
\textsuperscript{61} EC Regulation, \textit{supra} note 59, at para. (1) & (2) art. 4.
\textsuperscript{64} Bradley, \textit{supra} note 5, at 279.
\textsuperscript{65} \textit{See} Grossfeld, \textit{supra} note 62, at 270.
\textsuperscript{67} \textit{MURRAY}, \textit{supra} note 18.
\end{footnotesize}
semiotic system of “double-entry bookkeeping,” probably from China, showed itself to be so vastly superior over former means of financial controls that it became a means of life or death for competitors within the growing European markets.  

The newly created Order of the Franciscan Monks at the end of the twelfth century realized that their clientele, the Christian bourgeoisie in the big Italian cities, depended on the new art to compete effectively with established traders and bankers. In 1472 they promoted the first communal bank, the Monte de Pieta de Siena, which still exists as one of the major Italian banks, and provided it with the necessary accounting know-how. Small wonder that it was a Franciscan monk, Luca Pacioli, who published the groundbreaking book on accounting in 1494. Pacioli was the leading mathematician of his times and professor at the papal university in Rome. His book was the first on mathematics in Italian, which reflected in the Franciscan tradition of using the local language instead of Latin. Translations of the text first into Flemish and from there into English, French, and German tried hard to be faithful to the rationality and to the details of this great source. But what occurred is what happens with all legal transplants. Under the impact of new needs in different geographical and semiotic environments, they inevitably change their content. It does not add very much to ask which is better; it all depends on innumerable other factors.

69 Id.
70 Id.
72 See Robert Taylor, No Royal Road: Luca Pacioli and His Times (1942).
74 Grossfeld, supra note 71.
75 Bernhard Grossfeld, Strength and Weakness of Comparative Law (Cambridge 1990).
76 Bernhard Grossfeld, Comparative Law as a Comprehensive Approach, 1 RICH. J. GLOBAL L. & BUS. 1 (2000).
X. Convergence

The answer would be easier if the global environment for accounting were homogeneous. But that is not the case. “Global” does not fully reflect the reality that continues to be characterized by different business patterns and divergent cultural views of the world. This is too often overlooked in accounting as the magic of the same numerals worldwide pretends to mirror a general objectivity. But it is always mathematics in contexts. Therefore, our craft is local first.

Hopefully, the two sets of standards might converge as global corporations need a level playing field. Harmonized principles or rules are a more reliable basis for global group accounts. The pattern is set by the new rules of merger accounting, doing away with the merger of equals, turning to the use of the purchase method, which recognizes good will, and introducing the annual impairment test for acquired good will. This seems to have become a universal technique. Both sets also seem to be moving towards the mandatory expensing of stock options.77

Stock options are, however, a splendid example of the difficulties. It is still controversial how to value them and the discussion has turned into a dogfight. The vaunted Nobel-Prize winning Black-Scholes mathematical model78 makes options on highly volatile stocks look unduly valuable. But to be in favour of expensing does not necessarily show, as somebody from Nasdaq felt highly qualified to say, “the stultifying lack of opportunity that characterises Europe and much of the world” nor does it indicate the attempt “to lower America to their own pitiful level of innovation.”79 I wonder how this expert will explain why the gains reaped from stock options exercised by employees provide a federal income-tax deduction for the corporation if options are not expenses in the financial statements. This is a tricky question.


Every culture has the right to evaluate the quality of its own. Therefore, we should not plead convergence too early.

So far, lawyers unfortunately have little experience with accounting, and after such a long sleeping period, we should be careful not to become hyperactive, to beat all the bad guys in business, accounting, and law. Now, some people tell us that there can only be one correct answer to any legal question. But this pseudo-religious belief, not convincing even on a national level, has no chance in intercultural relations.

XI. Different Standings of Rules

A rule-by-rule comparison of both sets is moot for still another reason. They are presently, and probably even culturally, not on the same level. The core of the criticism by an Australian observer is that “GAAP is dominated by extensive detailed prescription of accounting practice.... GAAP standards may be observed to the letter of the law but not to the spirit of the accounting standard as law.”

A. Rules v. Principles

I am not going to say that the International Accounting Standards are better because they take another approach. They provide some broad statements of accounting principles to limit attempts to bend individual rules. Let me illustrate from my experience. When my teacher Ulrich Leffson and I introduced the “true and fair view” concept into the German Commercial Code as an overriding principle, we wanted to emphasize the responsibility not just for piecemeal details but for their balance in an overall picture of the financial statements. We met strong opposition from accountants who wanted to protect their turfs. They feared to lose their flexibility, call it adaptability, and preferred a cookie-cutting approach in order to increase the size of their cookies. We argued that markets and creditors need comprehensively balanced views, that numbers have no existence of their own but need a consistent frame, and that statutory limits give auditors greater independence from clients’ pressures.

80 George, supra note 56, at 56.

81 See German Commercial Code § 264 (“annual account”); id. at § 292 (“group account”).
We were successful, and in the meantime, the European Court of Justice has confirmed our views.\textsuperscript{82} It held that the "European principle of truth" was the overriding yardstick for every detail wherever located in the financial statements.\textsuperscript{83} This decision stands behind the European Union's accounting proposals that have to be in line with it.\textsuperscript{84} It opened doors for lawyers to bring new views into an otherwise closed universe. We sang a new song, not about accounting, but in accounting.

\textit{B. Authority}

The differences lie even deeper. They go into the centre of our views about the position of rules in our cultures, which in turn affect the hermeneutics and the application. Even a harmonization of the texts might not do the job.\textsuperscript{85} Each culture reads a concept with different emotional connotations, thus giving it another content.\textsuperscript{86} This occurs even when both use the same language, as between England and the United States.\textsuperscript{87} In our context, the question immediately comes up, to what extent do accountants, lawyers, and judges in different cultures feel themselves to be bound by written laws or other authoritative statements, call them "rules," "principles," or "standards"? How strong is the letter of the law in its particular social environment? To what extent is language regarded to be reliable?

As we just learned, the Generally Accepted Accounting Principles do not contain principles but detailed rules. What's in a name? What does "generally accepted" mean? Accepted by whom? Are these words other than air kisses? The structure of the American judicial system of professional judges and jurors also comes into play. As law is largely, though often unconsciously, defined by the organisational structure of the


\textsuperscript{83} Id.

\textsuperscript{84} EC Regulation, \textit{supra} note 59, art. 3 para. 2.

\textsuperscript{85} See Anne-Catherine Hahn, \textit{Comparative and International Law in a Multilingual Environment}, 30 INT'L J. LEGAL INFO. 265 (2002).


actors, the concept of law may be different in the United States and in Europe. Consider the differences between judges in the United States and England. The American jury diminishes the status of written laws considerably. As far as I understand it, the jury does not read. Does it understand the jury charge? This is a black box. How tight is the difference between fact and law? Facts can change the view of the law, and law can change the view of facts. These terms are chameleons. There is still much to be done by comparatists.

C. Interpretation

Likewise, the present law and economics ideology does not work in favor of rules. When we can rely on efficient markets as a kind of “invisible hand,” rules might be an obstacle to reach economically proper results. Constant remarks about the necessary liberality of corporation law proposing “contracts as salvation,” spillover into the interpretation of rules. It encourages a flexible interpretation, not spirit oriented, and it might even set a prize on clever circumvention. Traditionally, the rules against usury are another fine example for such temptations and now “Sprints” from stock options into tax shelters are catching up. These incentives are the stronger as the “invisible hand” of the market has deep religious, and therefore ethical, underpinnings. Adam Smith, professor of theology, got the idea from George Friderich Handel’s Oratorium “Judas Maccabaeus.” Judas sings:

How vain is man, who boasts in fight
The valour of gigantic might!
And dreams not that a hand unseen
Directs and guides this weak machine.

88 For a discussion, see Bernhard Grossfeld, Loss of Distance: Global Corporate Actors and Global Corporate Governance—Internet v. Geography, 34 INT’L L. 963, 968, 973 (2000).
91 GEORGE FREDERIC HANDEL, JUDAS MACCABAEUS (Hyperion Records 1992).
92 Id.
But the idea is far older. The cover page of the first French book on accounting (after 1500, the translation of Luca Pacioli’s book) shows a hand coming from heaven turning the golden circle (“deus geometra,” or “the geometrizing God”). It is not easy for mundane rules to compete with such heavenly-inspired concepts of order. How strong is the authority of rules when it is constantly undermined by other rational insights from above? What can we expect in particular from fresh-faced young people, when market efficiency is presented as the real rule of law?

D. Concepts of Time

All this is even more irritating in view of the fact that the reliance on only stock market transactions has a clear intellectual flaw. It confuses two different concepts of time, which cannot substitute each other completely. Stock markets have a short-term transactional, horizontal time structure. By contrast, corporations have a long-term institutional, vertical time structure. We take this into account in enterprise valuations as part of corporate law when we distinguish between the fair market value and the fair value of shares. Fair market value is the price expected when the shares are sold, whereas fair value is their proportionate value within a going concern. Also, short-term profits or cash flows are no safe haven for sensitively projecting long-term profits or cash flows and vice versa. Transactional views cannot fully explain the reality of corporations as part of our social security system. “For the time being” gets a different meaning in different factual contexts. Even though we moved from status to contract, there is still some status and some need for it left.

XII. Different Corporate Views

A. Shareowner Value

Other different basis approaches also make a piecemeal comparison of accounting misleading. This is already true between English law and American law, both divided by a deep

93 Grossfeld, supra note 17, at 250.
95 HENRY MAINE, ANCIENT LAW 165 (Boston 1963).
There is no Anglo-American or American-Anglo law. American corporate governance concepts are thoroughly colored by shareholder or shareowner, a slight change in emphasis, value language. I call it "language" because of the doubts in its real existence that has persisted for a considerable time. Enron might have showed us that "management value" could have been the better word. Shareowner value runs parallel to capital market orientations. But though we do not underestimate the grip of capital markets, doubts exists as to whether corporations can be reduced to nothing more than capital flows. Be that as it may, creditor-oriented and social responsibility-oriented approaches in accounting may see a new future.

B. Social Responsibility

Accounting practices are also influenced by how legal models see the position of shareholders versus stakeholders, like labour or local communities. Here again, the shareowner concept does not look convincing. Far from being alien to government corporations, they are a product of it and have a franchise from society: they are creations of the law and of nothing else. It is from the incorporating state that they derive the privilege of immortality and limited liability, both features needing constant watering and nurturing by the legal system. Certainly, the debate does not lack hot air. It is a difference in degree, not more. Just last year Nestle, Switzerland, was thinking of taking over Hershey, only to be confronted with an action by the Pennsylvania Attorney General. The Attorney General wanted to prevent the takeover in the interest of the community where Hershey produces its chocolates. The shareowner value concept, likewise, cannot explain the rise of Chapter 11 insolvency proceedings. The firm is kept afloat mainly in the interests of creditors and other stakeholders, not shareholders. More than half of America’s state legislatures adopted other constituency statutes that allow directors

96 Grossfeld, supra note 76, at 8.
99 Id.
to consider the interests of all stakeholders.¹⁰⁰ Connecticut even requires them to do so.¹⁰¹

The greatest divergences exist, however, with regard to labor representation as we find them in various degrees in Europe.¹⁰² A typical example is the Volkswagen Corporation. Labor representation and a high percentage of shares held by the State of Low Saxony provide short shrift for shareholders when it comes to dividends.¹⁰³ Accounting rules serve an important role in this political/social model. Compare this with Delaware. Delaware corporations often do not operate in Delaware and have no employees there.¹⁰⁴ There is no political pressure from claims that shareowner interests would reduce local employment levels or would do harm to the local social security system.

C. Clients Value/Enterprise Value

Still other consequences occur when local views favor a client's value concept under the assumption that only happy clients make happy shareowners. Also growing is the idea that the ongoing vitality of the firm is the major point. As already mentioned, reorganizations in insolvency proceedings under the Chapter 11 U.S. Bankruptcy Code seem to support an enterprise as such a concept.¹⁰⁵ It might lead to more liberality towards hidden reserves in the financial statements and to changes for value concepts in appraisal situations.


¹⁰⁵ Supra notes 41-45 and accompanying text.
D. Persistence

These differences will not wither away soon. So far we have no international *lex mercatoria* in corporate matters, and attempts for an international code of conduct for transnational corporations have failed. Therefore, given the interactions of accounting with persistently different general concepts of corporate governance, I doubt whether one set of accounting rules will do the best job:

Companies—both domestically and internationally—use accounting differently in large part because of the different legal and regulatory environments in which they operate. Consequently, international accountants generally warn that quantitatively reconciling foreign accounting data to U.S. GAAP will often convey an illusion of comparability that does not exist. To understand a foreign company’s financial position, one must ultimately come to terms with the home country’s legal and regulatory environment as well as its accounting standards.106

It is not enough just “to articulate sweet sounds together.”107

XIII. Power Struggle

Law, says the priest with a priestly look,

Expounding to an unpriestly people,

Law is the words in my priestly book,

Law is my pulpit and my steeple.108

A. Power Brokers

There is more behind this than a discussion of corporate law matters. Here again, Delaware might serve as an example. It stands for the fact that the real power in any semiotic system goes to those who have the power to interpret. Whoever defines the hermeneutics defines the outcome and receives benefits from it. For this old priestly experience I refer to “The Holy Scripture,” to

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the letter of the law, and to the fact that numbering, writing, and accounting started in temple economies. Delaware stands in this now mundane tradition. Delaware takes advantage by an indeterminate, judge-oriented law that makes application by Delaware courts a necessity and excludes non-Delaware corporations from network benefits. It is also clear that Delaware corporation law is a proprietary product of Delaware, which uses her interpretative power first in her interest.

Let us put these arguments into perspective and transfer them to the GAAP/IAS dichotomy, the perplexing patchwork compilation of the Generally Accepted Accounting Principles guaranty indeterminacy. Accountants and lawyers are brokers for myriads of transaction within a communicative power field. They convey, shape, and control the content. For good reasons, cultures hesitate to let this power fall into the hands of foreign brokers, whether legislators, standard committees, courts, lawyers, or accountants. Written rules are just plastics in the hands of interpreting priests. Given the power of accounting to create currency and to trigger and compound interests, economies want to control the actors and make their cultural view prevail on them. Priests count as the Bible tells us. “For when there is a change of priesthood, there is necessarily a change of the law as well.”

From this we can draw the conclusion—don’t put your fate into the hands of foreign priests.

It is at least understandable that after Enron and the demise of Arthur Anderson, non-U.S. accounting cultures do not want to become wholly dependant on the Federal Accounting Standards Boards, the Securities and Exchange Commission, or American courts, even outside of Delaware.

b. Job Opportunities

Standards of accounting are two different languages, and as always with languages, native speakers have the upper hand. That affects the activities of at least four industries: accounting, financial services, stock exchanges, and lawyers. They are language bound, and they will operate better and more profitably

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110 Hebrews 7: 12.
on their native grounds. It is clear that the interests behind the two competing sets want to retain their domestic turfs. They consider the job opportunities for the next generation.

XIV. Waterloo?

Given the present situation and reputation of accounting, a certain reticence towards rapid reforms might not be bad. The same skepticism refers to hopes for international treaties, which may be just another form of paper. The Wall Street Journal Europe gave us the following lesson:

The test should not be whether they were once “signed” but whether they serve better U.S. interests. Americans have deep mistrust against international tribunals, remembering Marbury v. Madison that gave a fledgling U.S. Supreme Court authority over the other branches of government. They do not want to give other tribunals to have similar power over “America’s democratic decisions and global leadership.”

Let's look at the central issues.

A. Chilier World

The implications of the present deficiencies, which are not American but universal phenomena, go beyond technical repairs. The Generally Accepted Accounting Principles have lost their glamour. But not only is their reputation severely damaged, but also accounting, as such, has suffered a blow. Consequently, the world of accounting and auditing will become chiller in the wake of Enron. Potential conflicts of interests and audits enter into the focus, and calls for less stringent requirements will be deflated in any set. Independent board members are encouraged to be more active watchdogs, not lapdogs, because management will be personally liable. This will contribute to higher costs for audits, accountants, corporate executives, and outside board members. Multinational firms in particular will feel the burden. Possibly so

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will lawyers.

How far can we go with regulating, regulating, regulating? Is it enough to ensure the accountant’s independence more tightly, following the pattern set by the European Commission? Do we create even more constructions that sound and look nice but might not reach global reality? Accounting is a product of the mathematical custom that came into Europe with the Arabic numerals. Does it still meet the expectations in our present environment? The belief in the globally comprehensive rationality of numbers came to its Waterloo. The underlying assumptions are built on shifting sand and even on quicksand.

B. Distrust

We must conclude that the standards for the preparation of accounts are inadequate and sometimes clearly misleading. An end to the trust gap, the accountability gap, is not yet foreseeable. Investors are fleeing stocks because of a general distrust in accountants, analysts, and regulators. Do we still need accountants as watchdogs, if they cannot fill the expectation gap? There is much pressure on accountants to go with the flow, with the common mood, and to acquiesce in the clients’ maneuvers as client pleasers. Accountants have a public mandate that guarantees them business in return for holding a public trust. But are these two aspects still in balance? Do we have to admit failure and eliminate the mandatory public audit altogether? I would not go that far.

XV. Limits of Signs

These remarks are no reason for pessimism or even skepticism. A certain amount of normative competition is the basis of an ongoing discussion and a confession that we are still, and will remain, in a stage of trial and error. But beyond that, we have probably overstated the reliability of accounting and financial


115 George, supra note 56, at 52.

statements. Were the emperor’s new corporate governance garments really what the courtiers pretended it to be? Did they believe, and did they make us believe, in the reality of the world created by their numbers?

This reminds me of a German poem by Christian Morgenstern called the “Impossible Fact”\textsuperscript{117} in which a deep thinker was run over by a car. The intellectual consequence was as follows:

Tightly swathed in dampened tissues
he explores the legal issues,
and it soon is clear as air:
Cars were not permitted there!\textsuperscript{118}
And he comes to the conclusion:
His mishap was an illusion,
for, he reasons pointedly,
that which \textit{must} not, \textit{can} not be.\textsuperscript{\textsuperscript{119}}

What we learned in the meantime is this. No semiotic system, be it letters or numbers, fully grasps reality, nor ever fully gets a grip on it. In a patchwork national environment, we have the power, at least temporarily, to squeeze reality into our semiotic systems and the ways they make us see and think about the world—authority, not truth, creates the law.\textsuperscript{120} Globalization takes this power from us. Semiotic systems then appear more familiar, more reliable, and more comprehensive than they are, and the governing priests are constantly trying to keep us as uncritical believers. But who are the global priests? In global commercial activities, what counts are trustworthiness, integrity, and consistency. Whom can we trust as a global partner? How can we find out? What can semiotics tell us about this decisive factor?

In addition, we are often lost in translation—from reality to signs, from signs back to reality. Several steps are involved. First, from the real world (e.g. real estate) into the legal term (property), and then, second, into the language of numbers. The reader has to


\textsuperscript{118} \textit{Id.}

\textsuperscript{119} \textit{Id.}

retranslate the numbers into law and from there to reality. This has some parallels in the game that children call "silent post."

Certainly, accounting is useful and it helps, but we need more than just the ability to read and write. We need a sensitivity analysis to "save the appearances."\textsuperscript{121} We have to develop a better understanding of the facts underlying our concepts—not ideas about the thing, but the thing itself, "a new knowledge of reality."\textsuperscript{122} Or, as we may say in simpler words, not only top-down but also bottom-up.

I believe that this opens new chances for lawyers. Remember the fairness opinions in merger transactions,\textsuperscript{123} the fair value requirement in appraisal proceedings.\textsuperscript{124} This latter field might become of particular importance for North Carolina lawyers. The newly established shareholder action by majority consent seems to trigger the statutory appraisal remedy for dissenting shareholders.\textsuperscript{125} The Sarbanes-Oxley Act brings new litigation implications. But the people that now have to certify the truth of financial statements, the members of auditing committees, to whom can they turn for help? Whom can they trust?

XVI. Valuation

\textit{A. Legal Expertise}

Lawyers should become more aware of the changing world of accounting.

The "art"\textsuperscript{126} of valuation techniques entered the world of accounting and changed it dramatically. Accounting has no stand-alone position anymore. This was brought about by the annual impairment test following FASB No. 142, following the new

\textsuperscript{121} Owen Barfield, Saving the Appearances: A Study in Idolatry (New York 1965).
\textsuperscript{123} Smith v. Van Gorkam, 488 A.2d 858 (Del. 1985).
\textsuperscript{125} Thomas L. Hazen, Silencing the Shareholders' Voice, 80 N.C. L. Rev. 1897 (2002).
\textsuperscript{126} In re Shell Oil Co., 607 A.2d 1213, 1221 (Del. 1992).
merger concepts under which pooling of interests is out. Corporations have to show the acquired goodwill and can leave it on their balance sheets indefinitely as long as it is not impaired. The impairment has to be tested by enterprise valuation techniques. The statement no. 142 refers to Concepts Statement 7 and brings the major excerpts in Appendix E. This is a gateway for lawyers willing and prepared to do the job.\footnote{127}

Courts are now entering the field with ever increasing speed and expertise. In \textit{U.S. Inspect, Inc. v. Noris F. McGreevy},\footnote{128} the Circuit Court of Virginia gives us a splendid review of the presently prevailing valuation techniques. It starts with fair value as opposed to fair market value, proceeds to the expected present value and the use of probabilities, discusses future cash flows and interest rates, and takes care of discounts\footnote{129} and control premiums.\footnote{130} What else do we need?\footnote{131}

\textbf{b. Cross Border Valuation}\footnote{132}

I would like to delve a little bit deeper into this field as it gives me the chance to add a global touch to my subject. Indeed, due to the multitude of transnational corporations, valuation proceedings often have trans-border implications. That is a prime example for the statement I made before, that accounting and valuation matters cannot be seen in the abstract. They always refer to the model that stands behind the corporation law and the corporate structure in general, behind the management, shareholder or stakeholder views or behind the enterprise as such.

Foreign appraisals, for instance, cut lines and distribute wealth between and to stakeholders whose concerns our culture has swept...
under the carpet. In other countries they may appear in some silent, disguised ways, and affect the outcome of any valuation. We learn first that the mathematics in accounting and valuation are a kind of non-linear mathematics of probabilities that we can never completely control. We learn second that they are always mathematics in context, in different cultural contexts.\textsuperscript{133}

XVII. Rating

Another factor lawyers should become interested in is rating. Today it is more important for a firm’s social credit, for its financial standing than any financial statements. Rating has achieved a silent revolution in the world of financing and of financial control and created a reorientation. We are not informed about the past but receive, hopefully, educated guesses about the future. Enron opened our eyes to a new hierarchy of social norms. It was not accounting, but rating, driven. At least, it bent the accounting principles to the requirements of rating. Rating is also used by public authorities in a regulatory context. The prime examples in Europe are the newly proposed Basel II Guidelines\textsuperscript{134} to be applied on a consolidated basis for “internationally active banks” at every tier within the banking group. They define the total minimum capital requirements for credit, market, and operational risks. New standards of corporate governance appear on the horizon.

So far, lawyers have shied away from rating, but the law will not. The rating agencies come under fire for not picking up earlier on a wave of corporate malfeasance. They reduced their grades just three days before Enron went bankrupt. France is fuming and crying foul because of the downgrades for big French corporations (e.g. Alcatel, France Telecom, and Vivendi Universal) that treat their employees well and are good corporate citizens. To what extent does this matter in rating? Could there be different cultural views? If we are told ad nauseam, that business ethics pay and that money is not everything, why not have policies reflecting

\textsuperscript{133} Cf., Lessons from Abroad: Mathematical, Poetic and Literary Fictions in the Law, 115 Harv. L. Rev. 2228 (2002).

rating? Anyhow, the agencies' monopolistic power is discussed in the European Parliament, and the Securities and Exchange Commission seems to be stirred up by Enron and Section 702 of the Sarbanes-Oxley Act. New proposals for the Nationally Recognized Statistical Rating Organizations (NRSRO) are expected. Conflict of interest issues will play a prominent role. Let's wait and see, but not too long. New work for lawyers is on the horizon.

In global relations, reading and talking alone cannot match the challenges. We do not find the answers in paper, more paper, and evermore paper. Lawyers need experience outside the narrow paths of legal literature, court decisions, and legal logic from too much logical sign dependency to more chaotic fact orientation.¹³⁵

XVIII. The Lawyers' Job

So far, lawyers have cared little for finding out, be it through accounting, valuation, or rating. But global markets don't care so much for letters, nor numbers, nor for the logic deducted from them. The answers are location, facts, and communication. Let us say it the Texan way—global financing and global control are no "staked plains." They are an open unstaked wilderness, constantly to be watched and to be reassessed. Therefore, before trying to regulate lawyers, we have to understand what is going on from a face-to-face encounter with the subject matter, with the underlying reality.¹³⁶ They must be trained to gauge the global economy not just from letters and numbers,¹³⁷ but from insights into the economic incentives for human behaviour.¹³⁸

I do not want to propagate multidisciplinary practices.¹³⁹ The dependence on the client, the art of knowing what to tell him and what not, and the risk of losing the whole flow of revenue from the

¹³⁶ See Exodus 33:1, Corinthians 13:12.
¹³⁸ GARY BECKER, ECONOMIC APPROACH TO HUMAN BEHAVIOR, 3–14 (1976).
firm is different in other lines of business. But so far, we have relied too much on our own world built from words, numbers, and letters, which we regarded as having a universal standing. The lawyers' narrowness in these fields has often been hailed as their main talent and their main ability. But they have to understand the function of markets and their effects on structures, from micro-justice to macro-justice.\textsuperscript{140}

Traditional lawyers only work effectively within a traditional, relatively stable territorial and temporal environment. But as soon as the concepts of space and time change, a new frame of reference is created. Our semiotic instruments lose their basis and their meaning. It is no longer possible to drop the magic words of having a lawyer call to solve a problem. It is no longer sufficient to pretend to know and sit through interminable meetings without any new ideas. Lawyers have first to find out about the new reality before talking about it and building verbal and literal constructions around it.

XIX. Sensitive Approaches

To meet the challenges of a new socio-economic pattern, where knowledge and information are sources of added value and power, we have to find new regulatory answers.\textsuperscript{141} Lawyers tend to be trained victims entrenched to believe in their particular semiotic systems as if they were an objective mirror of the world. But we have to be aware of the silent and invisible assumptions\textsuperscript{142} and of the inevitable limits of our systems. Under new conditions we have to rely on all our senses.\textsuperscript{143}

To find out what makes sense in the partly new world, we need our "Fingerspitzengefühl" (the "gentle feeling in the tips of our fingers"). No system can give us the answers. We are thrown into trial and error, into various approaches that hopefully support and correct each other. We will find our way somewhere between chaos and cosmos, between shifting sands of order and disorder.


\textsuperscript{141} See Esin Örüçü, \textit{Law as Transposition}, 51 INT'L & COMP. L. 205, 212 (2002).

\textsuperscript{142} Grossfeld, \textit{supra} note 132, at 369.

We cannot pinpoint dynamic currents through words, numbers, letters, and individual cases. They are always concepts of the past tested only for a future that we hoped to govern on our own turfs. Such a normative approach tends to become "baloney, baloney, baloney" because it does not match the realities of a global environment that is beyond our control. Instead of talking about new rules right away, we should talk about the facts. This is the first rule for lawyers themselves to follow, before they invent new norms for others. Charity begins at home.\textsuperscript{144}

XX. Conclusion

Certainly, rules of accounting are important for corporate governance. But I do not believe that our main comparative efforts can already be directed first to the GAAP-IAS dichotomy. By getting too much involved in details, we might lose perspective for the new developments that need all our energy, the energy of lawyers. Only then can we achieve a fully global corporate assessment. This is of prime importance for future corporate governance. As always, human actors act before and behind the scene. After Enron, we can no longer leave these positions only to accountants.

The old saying is that the law sharpens the mind by narrowing it, and sometimes we hail this paucity as thinking like a lawyer. But we are on the verge of having to pay a high price for this kind of lawyering. Unfortunately, most law schools have not seen their challenges and their chances in the field of accounting. They continue to emphasize Delaware law and to discuss accounting rules in general terms, leaving the rare courses in accounting for lawyers to be taught by adjuncts. "Valuation" and "rating" are words seldom heard at law schools. Our students should get the opportunity to obtain the basic crafts of these arts and to learn the details when they go along. It is time for lawyers to care about accounting, as lawyers.

\textsuperscript{144} Grossfeld, \textit{supra} note 76, at 368.