Semiotics, Hermeneutics, and Cash: An Essay on the True and Fair View

Lawrence A. Cunningham

Follow this and additional works at: http://scholarship.law.unc.edu/ncilj

Recommended Citation
Available at: http://scholarship.law.unc.edu/ncilj/vol28/iss4/5
Semiotics, Hermeneutics, and Cash: An Essay on the True and Fair View

Lawrence A. Cunningham∗

I. Roots of the Issue ................................................................. 897
II. The Semiotic Challenge .......................................................... 902
III. Select Global Responses ......................................................... 913
   A. Hermeneutics ................................................................. 914
   B. Anarchy ............................................................................ 919
   C. Struggle ........................................................................... 922
IV. Cash to the Rescue ................................................................. 924
   A. Utility ............................................................................. 925
   B. Standing ......................................................................... 929
   C. Next Steps: Toward A Conclusion ........................................... 932

Despite three decades of regulatory efforts in global accounting to promote the hoary true and fair principle (dating to Nineteenth century Britain),1 it remains an elusive touchstone. Notwithstanding the cash flow statement’s relative infancy (twenty-five-years-old in the United States and younger than five in Europe)2 and comparatively little regulatory effort promoting it, the cash flow statement is emerging as the unifying talisman of global accounting.3 The connection between the true and fair view and the cash flow statement is a hidden gem among the roughage contained in the U.S. Sarbanes-Oxley Act of 2002 (SOX).4 The

∗ Professor of Law and Business, Boston College. Copyright Lawrence A. Cunningham, 2003. All rights reserved. The author would like to thank Bernhard Grossfeld, Stanley Siegel, and Joseph Tham for their comments and Scott Bleier for his research assistance. The author can be reached via email at Lawrence.Cunningham @BC.edu.

1 See Michael J. Mumford, United Kingdom, in EUROPEAN ACCOUNTING GUIDE, 1134, 1134 (David Alexander & Simon Archer eds., 3d ed. 1998).

2 See infra text accompanying notes 216–43.


4 Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley)
gem creates an opening to address the largest contemporary problem for global accounting: one array of important principles (Anglo-American) is designed for capital markets whereas another array (Euro-Japanese) is not.5

The early solution to the problem of competing accounting systems, contained in the European Union’s Fourth Directive in 1978,6 called for preparing financial statements that give a true and fair view of a company’s condition and results.7 This directive turned out to be less a solution than a step toward finding one. The semiotic challenge was too great to make it a solution. True and fair balance sheets and income statements signify different qualities in different contexts within the United Kingdom and the United States.8 Moreover, what is true and fair in France or Japan is quite different from what is true and fair in Germany. Differences amplify across systems.

One solution to the semiotic challenge is hermeneutic: an argument that a country’s corporations can adhere to their nation’s methods of computing book value and net income, provided supplemental disclosure enables a reader interacting with the entire set of financial statements to create a hermeneutic circle that

---

5 The designations Anglo-American and Euro-Japanese are shorthand references to systems in place, respectively, in (a) the United Kingdom and the United States of America or derived from them and (b) Japan and the majority of leading European countries such as France, Germany, Italy, Denmark, and Sweden, though not including the Netherlands. These classifications are deliberately general, for substantial differences in background culture and particular accounting principles endure between countries within these broad groups. See e.g., JOHN BLAKE ET AL., INTERNATIONAL ACCOUNTING HARMONISATION: A COMPARISON OF SPAIN, SWEDEN & AUSTRIA, 33 (Universitat Pompeu Fabra, Economics Working Paper No. 294, 1998), available at http://www.econ.upf.es/docs/papers/downloads/294.pdf (highlighting the differences between Spain, Sweden, and Austria). More precise cultural gradations would recognize categories such as Romanic, Germanic and Nordic, and finer gradations yet are useful in certain contexts.

6 David Alexander & Simon Archer, An Overview of European Accounting, in EUROPEAN ACCOUNTING GUIDE, supra note 1, at 1, 19.

7 By “early” I am referring to the precursor period of globalization, when contemporary efforts towards harmonization of global standards in a variety of fields began in earnest.

8 Alexander & Archer, supra note 6, at 20.
produces a true and fair view. This hermeneutic response, typified by certain German accounting scholars, ducks rather than solves the semiotic challenge. It leaves unaddressed the relativity of true and fair as a concept when used to describe accounting fidelity. The hermeneutic circle may yield a true and fair view, but that view remains in the eye of the preparer whose outlook varies across countries and contexts. Financial statement readers cannot close this circle.

Another solution to the semiotic challenge of harmonizing the true and fair view among global capital market accounting practices is to split a country's internal accounting systems. This is the response epitomized by France, which permitted its multinational companies to follow international group accounting principles in sync with Anglo-American interpretations of the true and fair view. Three bodies of French accounting evolved: (1) individual accounting, (2) domestic group accounting (both adhering to traditional French accounting law), and (3) multinational French accounting (absorbing Anglo-American traditions). Leading French accountants lament that this solution produced fragmented anarchy within French accounting.

Ultimate answers to the semiotic challenge remain elusive—though many countries, such as Spain, continue to struggle toward finding a comprehensive solution. The most immediate partial solution rests not in hermeneutics, anarchy, or struggle but in cash. The cash flow statement—a relatively recent innovation in the history of accounting—is unbiased by traditional accounting

---

10 Jacques Richard, France: Group Accounts, in 2 TRANSNATIONAL ACCOUNTING, supra note 9, at 1127, 1144.
11 Id. at 1143–44.
12 Id. at 1145.
14 Its predecessor, the funds flow statement, dates to the nineteenth century in Britain and was adopted by international standard setters in 1977. But its evolution into the cash flow statement did not occur until the 1980s, and it was not until the late 1990s that major countries including Britain, Germany, France, and Japan widely adopted it. See infra text accompanying notes 216–43.
systems, whether those systems are designed for capital market participation or other purposes.

Under any accounting system, earnings and book values can be measured and reported in innumerable ways depending on the system’s goals or the accountant’s ingenuity. Cash is not subject to such vagaries. The content and format of the cash flow statement, moreover, is virtually identical in all major countries—a unique achievement in global accounting. It gives a true and fair view without requiring additional effort to produce the picture—let alone to define the concept and generate international agreement on how to apply it.15 Ironically, the true and fair view requirement has not typically included the cash flow statement.

While the semiotic challenge has faced global accounting since at least the Fourth Directive in 1978,16 globalization raises the stakes. SOX magnifies the stakes by requiring top managers to certify that a financial statement “fairly presents” a company’s condition and results.17 This embrace of the “fairly presents” standard is nothing new for U.S. accounting, though requiring top officers specifically to attest that a company’s financial statements and disclosure meet the standard is new.18

The SOX certification standard agitates debate in global accounting concerning the true and fair view because some 1,400 SEC registrants are non-U.S. entities (about ten percent by number and twenty percent by capitalization of all SEC registrants).19 While SOX does not require the certification to cover the cash flow statement, SEC regulations implementing SOX do.20

15 See infra text accompanying notes 190–215.

16 The semiotic challenge antedates the Fourth Directive. The struggle endured within countries such as the U.K. and Australia following the tradition, and some international effects ensued from the struggle. But the catalyst rendering the challenge global in scope was the Fourth Directive and the environment of nascent globalization that marked its era.


18 See Alexander & Archer, supra note 6, at 7.


Accordingly, SOX's elevation of the "fairly presents" standard to officer certificates and the SEC's extension of SOX to cash flow statements connects debate concerning the true and fair view with the evolution of cash flow statements as both go forward in a globalized capital marketplace.\textsuperscript{21} 

The cash flow statement cannot solve all problems of global accounting, but it can produce uniform information concerning liquidity, solvency, credit capacity, performance, and even value. This information is vital to capital market participants. Cash flow data have the premier virtues of comparability across countries and accounting systems while simultaneously and uniquely bearing consistency with otherwise disparate national standards.

Accordingly, more intellectual and normative firepower should be wielded to study and exploit the role and possibilities of the cash flow statement in global accounting, auditing, and finance. The struggle surrounding the true and fair view need not be abandoned, but it may turn out to be a struggle worth less firepower than once seemed the case. Put differently, the cash flow statement offers the best short-term prospects for global accounting harmonization, while the true and fair view is, at best, a long-term project.

\textbf{I. Roots of the Issue}

The contrasting accounting systems in the United States and the United Kingdom versus Europe and Japan are ultimately rooted in the common law versus civil law traditions prevalent in these cultures.\textsuperscript{22} U.S. GAAP and British accounting\textsuperscript{23} draw authority by being generally accepted, promulgated chiefly by practitioners of the professions.\textsuperscript{24} In contrast, accounting

\textsuperscript{21} Many SOX provisions are headed for SEC exemption in the globalized world. While this provision is not slated for broad exemption, awarding one would not affect the link SOX draws between the "fairly presents" standard and the cash flow statement.

\textsuperscript{22} See \textit{e.g.}, BLAKE \textit{et al.}, \textit{supra} note 5, at 19–20 (describing Anglo-American and Continental European bias in three countries' accounting practices).

\textsuperscript{23} The term GAAP is not customarily used in Britain to describe generally accepted accounting principles there. Mumford, \textit{supra} note 1, at 1143.

\textsuperscript{24} This is also the case of Dutch accounting. Though the Netherlands otherwise follows a civil law tradition, it has developed commercial and company law provisions through a specialized court called the Company Division of the Court of Appeal. Martin N. Hoodendoom, \textit{The Netherlands}, in \textit{EUROPEAN ACCOUNTING GUIDE}, \textit{supra} note 1, at
principles in Japan and most continental European countries (the Netherlands is the major exception) draw their legitimacy from law, not general acceptance. The Anglo-American model produces greater flexibility and requires judgment on matters of substance among Anglo-American accountants. The Euro-Japanese model emphasizes greater constraint and a focus on processes among Euro-Japanese accountants.

The content of articulated accounting principles also differs across these cultures due to varying conceptions of corporate purpose. Traditional Anglo-American corporate purpose is to generate shareholder profits. Financial statements are prepared to reflect performance measured by current profits and financial condition useful to gauge future profit potential. Tax accounting is substantially an independent body of law that uses different conventions to calculate different bottom-line figures.

Euro-Japanese corporate purposes are more variable but tend to share a broader conception that encompasses promoting interests of constituents other than shareholders, including lenders, employees, and the state. Hence, financial reporting and tax reporting tend to be co-extensive. In the audience for whom accounting is conducted, lenders enjoy a privileged seat compared to equity holders. Particularly among Germanic corporations, long-term financial durability is elevated above short-term profits.

694, 700.

25 Alexander & Archer, supra note 6, at 1.

26 These characteristics of traditional conceptions and approaches to matters of accounting remain significant even as methods of interpretation between common law and various civil law traditions blend or overlap. See Carl Baudenbacher, Some Remarks on the Method of Civil Law, 34 TEX. INT’L L.J. 333, 337 (1999) (evaluating common law versus civil law methodologies (and variations within the latter across selected countries) and their mutual contributions to one another, and noting that the “true and fair” brings a distinctly common law idea to civil law traditions).

27 See e.g., Milton Friedman, A Friedman Doctrine: The Social Responsibility of Business Is to Increase Its Profits, N.Y. TIMES (Magazine), Sept. 13, 1970, at 32 (noting shareholder profits should be of primary importance).

28 See Wolfgang Ballwieser, Germany: Individual Accounts, in 2 TRANSNATIONAL ACCOUNTING, supra note 9, at 1241.

29 Id. The author notes:

Besides protection for the equity and debt holders, financial reporting, especially when published, also ensures continued existence of companies,
Corporate finance structures reinforce these differences in accounting's goals. Anglo-American finance is more heavily oriented towards equity and public capital markets. Equity owners tend to be dispersed and uninvolved in corporate governance, putting a premium on transparency in financial reporting. Euro-Japanese finance historically is more reliant on banks, and banks play a central role in corporate governance, making financial reporting opacity tolerable. Coupled with the direct role of employees in corporate governance, banks and corporate management may prefer such opacity.

German law and practice consciously permits, and often requires, on a wide scale what would be considered earnings management in the United States or United Kingdom. Germany is followed by numerous other European countries from fellow Germanic states Austria and Switzerland to the Nordic states of Denmark and Finland and to lesser and varying degrees by the Romanic state of Spain. The best-known example of what the United States and United Kingdom would call earnings management concerns hidden reserves.

Hidden reserves refers to the practice of designating what especially large limited companies, as a going concern. The public interest is involved in the fortunes of companies which are so large that their failure would have repercussions on whole sectors of industry and whole areas of the country. Since commercial accounting and tax accounting are interrelated, it is also the national interest that is being safeguarded, as well as that of the regions and municipalities which also benefit from the tax yield.

See Norbert Fischer et al., USA: Individual Accounts, in 3 TRANSNATIONAL ACCOUNTING, supra note 13, at 2861.

See id.

See Masatoshi Kuroda, Japan: Group Accounts, in 2 TRANSNATIONAL ACCOUNTING, supra note 9, at 1819.


See generally ENNO W. ERCKLENTZ, JR., 2 MODERN GERMAN CORPORATE LAW 440–64 (1979). Under German law, management is entitled to allocate to “free reserves” up to 50% of net annual earnings, reduced by obligatory funding of “legal reserves.” The corporate articles may authorize managers to allocate to free reserves up to 100% of earnings-after-legal reserves. The net effect is the pool available to draw dividends is far smaller in Germany than in the United States. The German reserves, moreover, are available to absorb losses in subsequent years. Together, the reserves build a financial reservoir around the German corporation, intended to enhance its survival. These moats may not be reduced by distributions to shareholders. Id.
would be considered profits under Anglo-American accounting as reserves that can be drawn on in future years. They appear as neither assets nor liabilities on a balance sheet nor as earnings on an income statement. The effect is a reduction in Anglo-American profits in flush years and an increase in that measure in lean years. In some cases, creating such reserves is compulsory, funding reserves at annual rates up to defined statutory maximums. This deeply-rooted "prudence principle" is designed to protect creditor interests and to sustain the corporation's survival.

Less well-known examples abound. All leases may be treated as off-book under German bookkeeping, whereas U.S. GAAP imposes an elaborate set of rules intended to distinguish between capital and operating leases and restricts the ability to leave leases off the balance sheet. German bookkeeping and U.S. GAAP both require disclosure of related party transactions, but in Germany, this category does not include the company's directors. German bookkeeping permits accruals for loss contingencies precisely to smooth income. Legal capital rules in the United States and Germany are intended to protect creditors, but the rules in the United States vastly favor shareholders compared to those in Germany.

The key sources of divergence between traditional French accounting and United States and United Kingdom accounting also relate to the distinctive conception of French corporate purpose and related finance and governance realities. The central role of the state seen in French corporate purpose produced accounting rules geared to government fiscal policies with tax law

---

35 Id.
36 Id.
38 Ballwieser, supra note 28, at 1241.
39 KIESO & WEYGANDT, supra note 37, at 1202.
40 Id. at 1203. U.S. GAAP on this issue is consistent with IASC standards. Id.
41 KIESO & WEYGANDT, supra note 37, at 1387. Italy is similar to Germany in this regard; Switzerland does not require related party transaction disclosure at all. Id.
42 Id. at 672.
43 Ballwieser, supra note 28 and accompanying text.
The shareholder orientation of Anglo-American corporate purpose produces income statements classified by function, such as the cost of goods sold, whereas the French state orientation produces income statements that define expenses by statutorily-specified type. Traditional French accounting conceives of assets in a patrimonial rather than an economic sense as interests in tangible property rather than bearing economic value.

Japanese GAAP is an admixture of various traditions, including United States, United Kingdom, and Franco-German traditions. An English translation of the recognized standards is “generally as fair and appropriate accepted accounting standards.” As in Europe, Japanese accounting standards derive principally from law, the Commercial Code, and various Ministerial Regulations of the Ministry of Justice. Japanese individual account rules and results furnish the basis for determining corporate income tax obligations. Japanese financial reporting is aimed at investors (shareholders as well as creditors), blending traditions prevalent in the United States and United Kingdom with those in Europe. Reports are intended to discharge managerial duties to shareholders and “coordinate the conflicting interests between the shareholders and the creditors.”

---

44 See Richard, supra note 10, at 1135.
45 Id. at 1137. The author notes:
This way of presenting the profit and loss statement clashes with the dominant Anglo-Saxon tradition. In the Anglo-Saxon countries the financial accounting systems, owing to their economic orientation, are narrowly connected to management accounting, and give priority to the permanent inventory method: this implies that the concept of revenue is the sales and that expenses are classified by function (the cost of sales method).

Id.

46 Id. at 1138 (distinguishing asset conception between economic claims of right and patrimonial interests in tangible property only and concluding that (1) “Due to the weak development of the stock markets, the French financial accounting has been marked by the patrimonial concept” and (2) recent stock market development “has driven French accounting authorities to allow for more economic rules”).
47 Kuroda, supra note 32, at 1819.
48 See id. at 1813–20.
49 See id. at 1826.
50 Id.
51 Id.
The hybrid character of Japanese accounting does not exactly put it between the United States/United Kingdom and Franco-German systems. It sets Japan apart. It is no easier for Japanese than for French or German accountants to meet the challenge of the Anglo-American true and fair view. These countries share law-based and process-driven accounting systems rather than profession-based or substance-driven.

II. The Semiotic Challenge

U.S. GAAP and British accounting have long adopted similar versions of the ultimate goal of financial reporting. In the United States, GAAP seeks to report business condition and results according to a “fair presentation” (or “fairly presents”) standard;\(^5\) in Britain, the goal is producing financial statements giving a “true and fair view” of business condition and results.\(^6\) These concepts, which differ subtly between the United States and the United Kingdom, were utterly alien to non-Dutch Europe until the “true and fair” view was sanctioned by the Fourth Directive in 1978, driven by the United Kingdom’s recent admission to the European Union.\(^7\) This was, and remains, a controversial provision.

The concepts of “fairly presents” and “true and fair” are not defined by law in the United States, the United Kingdom, or any country in Europe.\(^8\) This reticence reflects a common law sensibility in leaving to professional judgment the ultimate application of general rules to specific situations.\(^9\) The operational function of the standard entails that compliance with

---

\(^5\) Fischer et al., supra note 30.

\(^6\) See Terry E. Cooke et al., United Kingdom: Individual Accounts, in 3 TRANSNATIONAL ACCOUNTING, supra note 13, at 2619.

\(^7\) Id. at 2622–23.

\(^8\) See id. at 2620.

\(^9\) Some debate whether U.S. GAAP are better characterized as general principles or specific rules. This debate has no bearing on the methodology being described. Moreover, the debate is more of a distraction than a useful line of inquiry. SOX emphasizes the distraction, directing the SEC to assess whether a rules or principles based accounting system is superior. See generally Fred Gill, Principles Versus Rules, 28 N.C. J. INT’L L. & COM. REG. 967 (2003); Lawrence A. Cunningham, The Sarbanes-Oxley Yawn: Heavy Rhetoric, Light Reform (And It Might Just Work), 36 U. CONN. L. REV. (forthcoming 2003) (measuring comparative rule density to challenge conventional wisdom that U.S. GAAP is most rule-bound globally).
applicable accounting principles will presumptively, but not invariably, meet the standard. When such compliance does not, departures are necessary and override literal compliance. The traditional continental European approach exemplifies the traditional civil law system, laying down detailed rules in codes intended to mitigate the role of judgment. Compliance with those laws is both necessary and sufficient to produce financial statements meeting the requisite standards—departures are deviant.

A semiotic challenge arises from the contingency of the true and fair view. Its meaning varies according to the ultimate purpose and attestation of the accounts: what they are intended to depict. In the United States and United Kingdom, achieving the view may mean tracking revenues and expenses using the accrual system and historical cost accounting conventions that result in reports mirroring external business activity—lumpy or smooth. It may then call for adjustments when applying those conventions to particular events which fog the mirror. In Germany, achieving the view may mean conducting the same sort of tracking but also conducting an allocation of the profits used as hidden reserves according to internal corporate priorities among claimants. In France, state fiscal policies also drive outcomes. In both Germany and France, the true and fair view may be achieved by being faithful to all applicable rules, including tax rules and in Germany’s case, reserve norms.

Despite the shared aspiration of the “true and fair” view among these countries, an identical series of hypothetical transactions for a single business produces different results when prepared in accordance with each country’s guiding principles and norms. The differences tend to reflect an intuitive link with ultimate corporate purposes: in a period of economic prosperity, profits are highest under United States and United Kingdom systems, lowest among Germanic systems, and in between for France and Japan. In periods of economic setback, German profits are higher than those in the United States or United Kingdom.

International differences explain only part of the semiotic divergence. Within given countries, interpretation of the true and fair mandate varies. The British “true and fair” view dates to the
Companies Act of 1844. That Act, and a series of subsequent revisions, cast the standard as requiring a "full and fair" or "true and correct" view. These concepts originally expressed the link between a company's internal records and its external reporting.

All British Companies Acts since 1948, including those currently in effect, require a "true and fair" view. This still partly reflects the goal of fidelity between internal records and external reporting. But the linguistic change also reflects the impossibility of a view of the balance sheet and income statement that is "correct." There are a number of potentially correct reporting methods, and the current standard calls for producing one of them.

The word fair is intended to command that the reports fall within the range of fidelity to both the internal records and to economic reality. The word true is intended to negate its opposite—false. It is not truth in its essence that is being sought but the absence of lies, frauds, fabrications, and other falsehoods. Few Anglo-American accountants believe that these demands entail simply complying with applicable accounting principles. The demands call for overriding those rules when particular facts and circumstances indicate that such compliance would constitute falsehoods or be out of the range of fidelity to the economic records and realities.

58 See id. at 2620 (citing the Companies Act 1844, Companies Act 1856, and Railways Companies Act 1867).
59 See, e.g., id.
60 See Blake et al., supra note 5 (noting that in accounting, "there is no standard of absolute truth").
61 See Cooke et al., supra note 53, at 2620 ("The law does not require that ‘the’ true and fair view be shown but that ‘a’ true and fair view be shown.").
62 See, e.g., id. at 2620–21.
63 Alternative definitions view true as complying with the letter of rules and fair as complying with the spirit of rules. See Oriol Amat et al., The Struggle Against Creative Accounting, (SSRN, Working Paper, 2002), available at http://www.ssrn.com. The authors recall an old joke to illustrate the point. Id. A ship captain believes his first mate may be imbibing excessively so he makes a note in the ship's log that "the first mate was drunk today." Id. The insulted mate returns the volley by entering in the next day's log that "the captain was sober today." Both statements may be true, but the inference of the second may not be fair. Id.
64 The Dutch statute captures the ultimate goal of the true and fair view succinctly:
Economic realities are measured by the instruments of accounting, but the common law mind-set doubts its ability to craft *ex ante* rules universally applicable to address them faithfully. Accounting rules are tools, not truths; judgment is necessary to determine that their application in particular settings produces faithful measures of economic reality.

Accounting figures produced by rules are not inevitably the truth or inevitably a faithful representation of reality. They must be tested as such and when they cannot be verified as such must be departed from. One important consequence of this stance is that identical economic transactions conducted by different companies within the same country or in different countries may require different reporting.

U.S. law generally rejects that compliance with GAAP satisfies the "fairly presents standard," at least with respect to an accountant's exposure to liability for failing to meet it. The American classic is Judge Henry Friendly's decision in *United States v. Simon.* It affirmed a trial court's refusal to give a defendant-accountant's proposed jury instruction that he could be found guilty of accounting fraud only if, under GAAP, the financial statements as a whole did not fairly present the

---

The financial statements shall in accordance with generally accepted accounting principles furnish such information as to enable a responsible opinion to be formed regarding the financial position and the profit and loss and, to the extent that the nature of financial statements permits, regarding the solvency and liquidity of the corporate body.

Martin N. Hoogendoorn, *The Netherlands,* in *EUROPEAN ACCOUNTING GUIDE,* supra note 1, at 706 (quoting *Raad voor de Jaarverslagging* (the Council for Annual Reporting, known as the RJ), § 362(1)).

The common law sensibility assumes particular significance when applied to matters of accounting, where business environments evolve, technological innovation outpaces accounting tools, and the available principles of accounting fail to capture all economic particulars that may be relevant. *See id.* at 1143. It is "impossible to prescribe exactly what matters will be significant to readers from one year to the next. *Id.* Hence, it is not possible to lay down exactly what will be necessary to convey a true and fair view." *Id.*

*See* Cooke et al., *supra* note 53, at 2621 ("a term such as ‘true and fair view’ could end up meaning many more things than the various things it represents to different groups of the same or different societies.").


*Id.*
company’s financial condition (and then only if the departure from GAAP involved willful disregard and the accountant knew the financials were false and held an intent to deceive).\textsuperscript{69}

Rejecting this proposed instruction, Judge Friendly instead defined the issue as whether the financial statements, taken as a whole, fairly present the company’s financial condition and results.\textsuperscript{70} If they do not, then the issue is whether the accountant acted in good faith.\textsuperscript{71} Proving compliance with GAAP evidences good faith but is not conclusive.\textsuperscript{72} A relevant factor includes the authoritative quality of the sources relied on in forming the judgment about what GAAP required.\textsuperscript{73} This perspective reflects U.S. GAAP’s roots in numerous sources not articulated in a single code.\textsuperscript{74}

The SEC certification requirements implementing SOX restate the U.S. conception of “fairly presents” and its relationship to compliance with GAAP.\textsuperscript{75} The regulations require certification that “the overall financial disclosure fairly presents, in all material respects, the company’s financial condition, results of operations and cash flows.”\textsuperscript{76} The SEC clarifies that the certification is not

\textsuperscript{69} Id. at 805-06; see also SEC v. Seaboard Corp., 677 F.2d 1301 (9th Cir. 1982). But see SEC v. Arthur Young & Co., 590 F.2d 785 (9th Cir. 1979).

\textsuperscript{70} Simon, 425 F.2d at 805.

\textsuperscript{71} Id.

\textsuperscript{72} Id. at 805-06.


Compliance with generally accepted accounting principles is not necessarily sufficient for an accountant to discharge his public obligation. Fair presentation is the touchstone for determining the adequacy of disclosure in financial statements. While adherence to generally accepted accounting principles is a tool to help achieve that end, it is not necessarily a guarantee of fairness.

\textit{Id.}

\textsuperscript{74} See Shalala v. Guernsey Mem. Hosp., 514 U.S. 87, 101 (1995) (noting that for many accounting issues as many as nineteen separate sources of authority could furnish guidance, and these may be conflicting).

\textsuperscript{75} The SEC and SOX are criticized for failing to specify the circumstances under which departures from GAAP are warranted or required. See Christian J. Mixter, United States v. Simon and the New Certification Requirements, 76 ST. JOHN’S L. REV. 699 (2002).

\textsuperscript{76} Sec. & Exch. Comm’n, supra note 20. The reference to cash flows is also notable. It is not contained in SOX, but the SEC added it by regulation, taking the
limited to an attestation that the financial statements accord with GAAP, emphasizing instead the broader requirement of "overall material accuracy and completeness." 77

In reaching this interpretation of Congressional intent and restatement of the U.S. norm, the SEC cites Judge Friendly’s classic opinion in United States v. Simon, 78 cautioning that "Presenting financial information in conformity with generally accepted accounting principles may not necessarily satisfy obligations under the antifraud provisions of the federal securities laws." 79 Thus, the SEC takes the position that a "fair presentation" is not about results alone but also about:

the selection of appropriate accounting policies, proper application of appropriate accounting policies, disclosure of financial information that is informative and reasonably reflects the underlying transactions and events and the inclusion of any additional disclosure necessary to provide investors with a materially accurate and complete picture of an issuer’s financial condition, results of operations and cash flows. 80

The SEC opines that this view is consistent with international standards, citing IAS 1’s reference to elements to be considered in a GAAP framework to determine whether financial statements "fairly present" condition and results. 81 These factors include "whether the disclosure is informative and reasonably reflects the underlying transactions and events." 82

---

77 Sec. & Exch. Comm’n, supra note 20. “We believe that Congress intended this statement to provide assurances that the financial information disclosed in a report, viewed in its entirety, meets a standard of overall material accuracy and completeness that is broader than financial reporting requirements under generally accepted accounting principles.” Id.; see infra Part IV.

78 425 F.2d 796 (2d Cir. 1969).

79 Sec. & Exch. Comm’n, supra note 20 (also citing In re Caterpillar, Inc., Release No. 34-30532 (Mar. 31, 1992); Edison Schools, Inc., Release No. 34-45925 (May 14, 2002)).

80 Id.

81 See id. n.56.

82 Id. The standards do appear consistent, though it is equally obvious that the SEC’s elaboration is broader than the IAS elaboration. Id. It includes as factors the selection and application of accounting standards. Does the SEC explanation comfort or
Even kindred countries, such as the United States and the United Kingdom, can diverge in the degree of confidence they show in presumptively meeting the “true and fair” or “fairly presents” requirement simply by complying with relevant accounting principles. The practice norm in the United States is that compliance is both necessary and sufficient. This is so despite a SEC rule expressly permitting departures when necessary, and a body of case law led by Judge Friendly’s opinion in *United States v. Simon* emphasizing that compliance with GAAP is not a defense to an action for fraud.

The practice norm in the United Kingdom is to recognize the need for overrides and a “preference for a dynamic interpretation of the accounting provisions,” despite a legal and theoretical presumption that departures should not be made. In fact, in 1981, the United Kingdom amended the Companies Act to provide for a required override explicitly—affirmative departures from otherwise applicable standards. A chairman of the Accounting Standards Board emphasized the virtue of the system as progressive in hastening the advancement of accounting practice to keep pace with business evolution. On the other hand, as in the United States, compliance does furnish a strong indication of achieving the true and fair view.

Countries attempting to follow the U.K. standard have devoted substantial efforts to offering precise definitions of the phrase true and fair view but remain befuddled in the quest. In Australia—
which has long followed U.K. accounting practice—1983 amendments to the Companies Act endorsed by the Australian Accounting Review Board adopted the override principle, requiring departure from rules if application failed to yield a true and fair view. Concern subsequently arose that directors were using this override provision not so much to meet the spirit of the true and fair view as to justify departures from undesired rules. As a result, in 1991, the law was amended again effectively to eliminate the override option and replace it with a requirement to add information necessary to give a true and fair view. This election was seen as the only sensible course given decades of futile effort among Australian accountants and regulators to define the concept of true and fair.

European countries enacting the mandates of the Fourth Directive adopted a range of responses from insisting on strict compliance with rules to permitting the override in defined contexts. The varying strategic responses were possible given the architecture of the Fourth Directive, which articulates three related components. Mandate 1 is the true-and-fair view itself: “Annual accounts must show a true and fair view.” Mandate 2 is

91 BLAKE ET AL., supra note 5, at 17 (citing M.A. SADHAN & I.A. LANGFIELD-SMITH, A QUALITATIVE STANDARD FOR GENERAL PURPOSE AND FINANCIAL REPORTS: A REVIEW 13 (Australian Accounting Research Foundation, 1993) (quoting statute: “Where compliance would not in the directors’ opinion give a ‘true and fair’ view the directors are required to add such information as will give a ‘true and fair view’”)).
92 See id. at 18–19 (summarizing various Australian efforts to define true and fair, including one commentator concluding that the concept while “making a pleasant appeal to the eye and ear” turns out to be “a snare and a delusion to the uninformed”).
93 Id. at 11. European Directives agreed by the Union oblige member states to enact compliant national legislation. Directives are issued in each European language and legislation is enacted in local languages. Language in translation does not always produce semantic identity, especially of specialized technical terminology such as the true and fair view.
94 Id. at 11.
95 Id.
for supplemental disclosure: "When the application of the Fourth European Directive is not sufficient to show a true and fair view, additional information must be given to reflect a true and fair view."\(^{96}\) Mandate 3 is an override principle: "If, in exceptional cases," the application of a specific principle from the directive, . . . a true view is not achieved, that principle should not be applied, explaining the reasons for the override in the notes to the accounts. This is the prevalence of true and fair over other accounting principles."\(^{97}\)

Despite the Fourth Directive's attempt at clarity, the resulting menu facilitates a wide range of strategic interpretations.\(^{98}\) Taken literally, Mandate 1's call for a true and fair view seems paramount.\(^{99}\) To a student of Anglo-American accounting (or Dutch accounting), Mandate 1 in itself carries particular contextual implications.\(^{100}\) This take holds that the true and fair view is intended to eliminate the use of hidden reserves and to distinguish between financial reporting and tax reporting.\(^{101}\) But this is by no means clear to a student of German, French, or Japanese accounting, where compliance with law—including use of hidden reserves in Germany and kindred states and of obedience to related tax accounting laws—creates a presumption of complying with the true and fair view requirement.\(^{102}\) Mandate 1 is met by such compliance.\(^{103}\) Thus, Sweden has adopted the standard of preparing accounts in accordance with accounting principles intended to produce a true and fair view but has refrained from applying the true and fair view override (of Mandate 3).\(^{104}\)

---

\(^{96}\) Id.

\(^{97}\) Id. at 11–12.

\(^{98}\) Id.

\(^{99}\) Id. at 11.

\(^{100}\) Hoogendoorn, supra note 64, at 700, 720 (noting that Dutch accounting is of an Anglo-Saxon nature that elevates substance over form and adopts the true and fair, written in Dutch as een getrouw beeld). The true and fair view override is established as part of the law and carries the duty to provide information in addition to what is specifically required by law. Id. at 706.

\(^{101}\) Blake et al., supra note 5, at 20.

\(^{102}\) Id. at 21.

\(^{103}\) Id. at 11.

\(^{104}\) Sigvard Heurlin, Sweden, in European Accounting Guide, supra note 1, at
The presence of Mandates 2 and 3 can be seen either to challenge or to reinforce the legitimacy of this stance.\textsuperscript{105} The presence of Mandates 2 and 3 challenges the stance to the extent the Mandates would otherwise be superfluous, dead letters.\textsuperscript{106} They must mean something and everyone knows they were added at the behest of the United Kingdom where the concept of true and fair originated.\textsuperscript{107} But meaning can be given to them by observing the theoretical possibility that adhering to bookkeeping rules may not produce a true and fair view defined in terms of those national rules either, though there may be far fewer circumstances when this is the case compared to those arising when applying U.S. or U.K. accounting.\textsuperscript{108}

The case for a weaker adherence to Mandate 1 is stronger yet when you consider that Mandates 2 and 3 can be read to provide alternative responses when Mandate 1 would otherwise be unmet.\textsuperscript{109} Thus, a preparer can provide supplemental disclosure under Mandate 2 or exercise the override directive of Mandate 3.\textsuperscript{110} The Australian history makes the point, since it once embraced the override principle reflected in Mandate 3 and later abolished it in favor of the supplemental disclosure approach reflected in Mandate 2.\textsuperscript{111} The menu-effect in Europe is real: Finland takes the true and fair view to require supplementary information in the footnotes when the standard would otherwise not be met,\textsuperscript{112} while Denmark has adopted the override principle in law but invocations of it are rare and the country’s deeply-rooted

\textsuperscript{105} BLAKE ET AL., supra note 5, at 11–12.
\textsuperscript{106} Id.
\textsuperscript{107} Alexander & Archer, supra note 6, at 19.
\textsuperscript{108} Id. at 19–20.
\textsuperscript{109} BLAKE ET AL., supra note 5, at 17–19.
\textsuperscript{110} Id. at 11–12.
\textsuperscript{111} Id. at 17–19.
\textsuperscript{112} Salme Näsö & Aila Virtanen, Finland, in EUROPEAN ACCOUNTING GUIDE, supra note 1, at 256. Adherence to “good accounting practice” (oikeat ja riittävät tiedot) remains the normal professional instinct of the Finnish-trained accountant. Notably, the concept of “good accounting practice,” like the concept of the true and fair view, has no precise definition in Finland. Id.
embrace of the prudence principle endures despite acknowledged conflict between the two.\textsuperscript{113}

Another factor strengthening this stance is precisely that the true and fair view’s home state of Britain leaves the concept highly contingent and potentially indeterminate (as does its chief follower, the United States).\textsuperscript{114} The impermeability of this semiotic challenge becomes clear when you consider that Italy translates the true and fair standard as “true and correct” (rappresentare in modo veritiero e corretto)\textsuperscript{115}—the original Nineteenth century U.K. position—which is then equated with Italian civil law dating to 1882 requiring “straightforwardness and truth” (evidenza a verità).\textsuperscript{116}

The Italian position reveals a fundamental issue of translation. European Directives are implemented according to the language of member states.\textsuperscript{117} While the Fourth Directive seems to compel using the phrase true and fair view, the phrase, nevertheless, must first be translated linguistically.\textsuperscript{118} Imprecision is the natural price of translation. A clear example of some sacrifice in precision is that many countries translated the true and fair view into a single word, muting the subtle complimentarity of the true and fair pairing painstakingly crafted in British accounting history.\textsuperscript{119} Thus, Greece uses “real” while France, Belgium, the Netherlands, Spain, and Luxembourg use “faithful.”\textsuperscript{120}

\begin{enumerate}
\item Carsten K. Hansen, \textit{Denmark, in EUROPEAN ACCOUNTING GUIDE, supra note 1}, at 207. Danish-trained accountants focus on the process, not the “holistic concept” of the true and fair “relating to the desired attributes of the end-product as a whole, seen from the users’ point of view.” \textit{Id.}
\item Alexander & Archer, \textit{supra note 6}, at 20.
\item Stefano Zambon, \textit{Italy, in EUROPEAN ACCOUNTING GUIDE, supra note 1}, at 581. In earlier legislation, Italy translated the terms as the French do, as faithful picture \textit{(quadro fedele)}. \textit{Id. at 583} (discussing Civil Code Article 2217, section 2). Italian accounting also requires presentation with clarity and precision \textit{(chiarezza e precisione)}. \textit{Id.} (citing Civil Code, Article 2423, section 2).
\item See BLAKE ET AL., \textit{supra note 5}, at 21–23.
\item See Nobes, \textit{supra note 117}, at 39–40.
\item See \textit{id}. Similar translation differences exist across Europe, such as right-looking and according to facts (Denmark) and true and appropriate (Portugal). \textit{See id}.  
\end{enumerate}
It is entirely legitimate, therefore, for those trained to understand financial reporting as a partial product of tax law and with a goal toward protecting creditors through prudent reserves to conclude that financial statements give a true and fair view when these principles are obeyed. The mind set is hard to change, just as the mind set of a U.S. or U.K. accountant accustomed to exercising judgment is hard to change to a greater process orientation.

Any legal or systemic principle when translated faces this challenge. It multiplies in the context of accounting because the exercise itself involves semiotic representation using principally numbers—supplemented by words—to depict complex economic reality. In the end, representational faithfulness is in the eye of the accountant, despite international agreement on ultimate goals, use of similar terminology, and (for Europe and the United Kingdom at least), a common legal text. Some global responses to the true and fair mandate have taken this legitimacy seriously, while others have struggled mightily to achieve legitimacy by other means. A closer look at these global responses follows.

III. Select Global Responses

International accounting standard-setters have toiled for decades on a harmonization scheme, work that has gained practical and accelerated momentum amid realization of globalization’s force in the latter 1990s and potentially greater urgency in the wake of SOX. All major countries joined the process of iterating between helping to draw international standards, adapting them in some manner into domestic standards and law, and then seeking to re-export them back into the international standard setting process. The iterative import/export process is most profound concerning the true and fair view

121 Alexander & Archer, supra note 6, at 21.
122 Id. at 20–21. For American readers, imagine if U.S. tax laws directed filers to follow rules defining their annual income, deductions, exclusions, and credits to compute taxable income and tax and then invited them to make an ultimate determination of whether the results present a fair view of the filer’s actual economic performance for the year.
123 See Nobes, supra note 117, at 39–41.
124 See Blake et al., supra note 5, at 7–8.
125 See id. at 20–26.
standard with nations offering alternative approaches to meet the semiotic challenge it poses. A capsule review of how selected major countries faced the challenge shows the enduring obstacles to harmonization that using the concept entails.

A. Hermeneutics

The chief pressure point on German accounting law is to transform traditional German accounting’s prudence principle into information useful for capital market participants. As in other major countries, the vehicle is development of accounting principles for corporate groups (known in the United States as consolidation accounting and in Europe and the rest of the world as group accounts).

As law, German group accounting is authorized by the legislature and developed by GASB under the supervision of the Ministry of Justice. Legislation now authorizes group accounting using IASC or U.S. standards until GASB finalizes German group accounting. This authorization led large numbers of German corporations to use those standards (at least fifteen percent of German listed companies). Conditions for taking the international option include that reports accord with EU Directives, are at least as informational as German Commercial Code requirements, and disclose how principles vary between group and German accounting.

---

126 See Nobes, supra note 117, at 39–46.
127 Group accounting is the term used around most of the world to refer to what U.S. accountants call consolidation (the EU’s Fourth Directive calls it this too but the term group remains the general reference). U.S. GAAP concerning consolidation dates to the 1950s with a formal pronouncement set out in Accounting Research Bulletin No. 51 in 1959. The basic principles have been well-settled for a long time and most technical aspects are now elaborated in accounting textbooks rather than formal promulgations. Fischer et al., supra note 30, at 2993.
128 Ordelheide, supra note 9, at 1362. New German group accounting standards are to be adopted by the newly-established German Accounting Standards Board (GASB—Deutscher Standardisierungsrat, DSR), which will include standards for cash flow statements and segment reporting. Id. at 1365.
129 Id. at 1360.
130 Id. at 1369 (as of August 1999, 15.4% of German listed companies (117 in total) so opted (73 and 9.6% IAS and 44 and 5.8% U.S. GAAP)).
131 Id. at 1369–70. German individual accounts are still critical for each entity and its determination of profit available for distribution and for taxes, as well as to investors
Despite these efforts, critics cite two features of German group accounting that impair the quality of financial reporting necessary for capital market participants: profit determinations are tax-driven and products of hidden reserve practices.\textsuperscript{132} Defenders argue that while individual accounts remain tax-driven, legislative authorization to prepare group accounts permits preparation unconstrained by the tax-driven rules and free of certain reserve norms.\textsuperscript{133} German multinationals in practice seem to opt for this flexibility, but German group accounting principles at present do not require them to do so.\textsuperscript{134}

As a matter of law, moreover, German accounting continues to adhere to its "General Norm" which calls for compliance with the principles of proper bookkeeping.\textsuperscript{135} The law also requires adherence to the true and fair view, but even within group accounting, this remains a subordinate principle in application.\textsuperscript{136} It is a nominal embrace of Mandate 1 of the Fourth Directive.\textsuperscript{137} When such adherence would fail to produce a true and fair view,
footnotes are to disclose what deviations would be necessary to produce a true and fair view.138 This is an embrace of Mandate 2 of the Fourth Directive.139 It reflects the civil law sensibility, in contrast to the common law sensibility, which would invoke Mandate 3’s override approach and apply different principles.

Whether the German approach alters or waters down the meaning of true and fair view or simply locates its achievement in a different place is a source of endless debate.140 The critical view declares that Germany has not embraced the true and fair requirement of the Fourth Directive (or the Seventh Directive, which extends itself to group accounting).141 This criticism assumes that the true and fair view relates to the numerical presentation on the balance sheet and income statement. The notes supplement these central features of the statements. The German hermeneutic response characterizes the numerical presentations and the notes as forming a unity constituting integral elements of the hermeneutic circle users create in reading financial statements.142

The stance is justified as a matter of positive law by virtue of the existence of Mandate 2’s disclosure provision as a seeming alternative to Mandate 3’s override provision.143 It has been rejected as a matter of positive law by the European Court of Justice.144

The justification as a matter of hermeneutics is also difficult to sustain. Hermeneutics is the centerpiece of a major innovation in civil law methodology, rooted in the work of Gadamer and Heidegger.145 In accounting, it refers to the process a user pursues

138 Gilbert Gélard, France: Individual Accounts, in 3 TRANSNATIONAL ACCOUNTING, supra note 13, at 1032.
139 See id. at 1032–33.
140 See Ordelheide, supra note 9, at 1372–73.
141 See id.
142 See id.
143 See Waltraud Tomberger, 1996 E.C.R. at I-3138–43. Note that the challenge facing Germany differs from that facing Australia. Traditional accounting differs between these countries due to their respective civil versus common law heritages and bank versus shareholder corporate finance traditions.
144 See id. at I-3141–43.
145 See HANS-GEORG GADAMER, TRUTH AND METHOD 345-448 (Garrett Barden & John Cumming eds. & trans., The Seabury Press 1975) (2d ed. 1965); MARTIN
in comprehending a set of financial statements.

A financial statement user starts with a pre-understanding of the rules governing its creation and approaches the statement with a purposive expectation of its meaning given those rules.\(^{146}\) So armed, the user's reading of the statement continuously requires adjustment to that pre-understanding as the information reveals new meanings.\(^{147}\) The relation between a user's pre-understanding and the incremental unfolding of new meaning through engagement with the statement and its component parts in this process forms a hermeneutic circle. The serial revision of one's pre-understanding through the process of reformation by absorption of the statement's parts constitutes comprehension. Thus, the elements of the statement—the numerical presentation as well as narrative footnote disclosure—collectively sustain the creation and realization of the hermeneutic circle.

According to this hermeneutic philosophy, achieving a true and fair view is possible either in the numerical presentation or in the notes.\(^{148}\) As a practical matter, moreover, this enables meeting both objectives, a Europe and capital-market driven true and fair view and a German and legislative driven mandate of the General Norm to comply with bookkeeping rules.\(^{149}\) Indeed, this is the only way to meet both objectives.\(^{150}\)

The difficulty with the hermeneutic circle as applied to

---

\(^{146}\) See Blake et al., supra note 5, at 10–11.

\(^{147}\) See Ordelheide, supra note 9, at 1376.

\(^{148}\) See id.

\(^{149}\) Id. at 1372–73. Apart from this debate in theory and law, however, in practice German corporate groups are leaning toward presenting the true and fair in the numerical data, subordinating the General Norm and implicitly meeting its requirements by footnote disclosure. Id. at 1373.

\(^{150}\) Id. at 1372–73. Consider the parallel domain of financial valuation. Modern finance theory (MFT) bears a greater resemblance to European traditions while fundamental valuation analysis bears a greater resemblance to Anglo-American traditions. MFT atomizes companies in markets and uses the pricing volatilities of traded securities to ascertain key valuation components, critically the discount rate or cost of capital. There is a tendency to believe in the objectivity of the results, a step insulated from professional judgment. Traditional fundamental valuation analysis applies a variety of rigorous tools and adheres to a body of principles but explicitly recognizes the importance of judgment in testing the results.
financial statements is that users of financial statements are unlike judges engaging legal texts or theorists developing literary interpretations. Financial statement users seek hard data concerning liquidity and value.\(^5\) They are far less likely to engage formally in such a process of complete comprehension compared to judges or literary users. Even at its best, financial statement analysis entails an exercise of isolating particular parts of the statements and relating these to each other.\(^5\) This risks leaving the hermeneutic circle unclosed.

Among standard analytic tools employed to read financial statements, moreover, are a series of financial ratios, such as the current ratio, the debt-to-equity ratio, the inventory turnover ratio, and the cash-interest-coverage-ratio. All these exercises rely on the numerical information contained on the face of the statement. Supplementing these by footnote disclosure is possible but does not guarantee a hermeneutic circle.

Even among jurisprudential and literary invocations of the hermeneutic circle, a judge’s or reader’s preconceptions cannot be eliminated.\(^5\) Biases persist. The magnitude of bias risk is greater in financial statement analysis. Psychology plays a formidable role among users of financial statements.\(^5\) For example, the saliency bias exposes users to the risk of overemphasizing numerical figures, particularly bottom line figures, in subordination to elaborate textual explanations. Such cognitive biases disrupt forming complete hermeneutic circles. In practical terms, therefore, the hermeneutic circle’s policy attractiveness is limited.

As a matter of logic, moreover, if the notes are intended to clarify the numbers, then an accounting system needs principles for the notes that are no more opaque. But if it is possible to establish such transparent principles for the notes, then it must be at least as possible to establish them for the numbers. And, if this

\(^{151}\) See LEOPOLD A. BERNSTEIN, FINANCIAL STATEMENT ANALYSIS: THEORY, APPLICATION & INTERPRETATION 72-73 (Richard D. Irvin Inc. 1974).

\(^{152}\) See id.

\(^{153}\) See Baudenbacher, supra note 26, at 348 (citing GADAMER, supra note 145, at 238).

clarification can be done in the notes, then it seems superior to do it in the numbers, given their relative saliency. The comparative need for fidelity is in the numbers, not the notes. This means promoting uniformity of assumptions made in preparing the numbers, not trying to develop clarifying assumptions to guide uniformity in the meaning and reliability of the notes. Accordingly, the hermeneutic circle does not meet the semiotic challenge.

**B. Anarchy**

The Anglo-American norm is translated in France as the *image fidèle*, which in turn traces to a preexisting French accounting concept undoubtedly bearing a different signification, *regularité et sincérité*. The French *image fidèle*, added by law in 1982 to meet European Directives, also calls essentially for complying with accounting rules. It is famously flexible, yielding the same image of fidelity when accounting is performed using different philosophies, so long as rules are followed. The varying philosophies yield various uses—not quite meanings—for the true and fair view. These have developed through the evolution of French group accounting, which is undergoing dramatic change.

In mid-1998 under pressure from France-based multinationals, the French General Assembly authorized these companies to adopt either IASC accounting standards or U.S. accounting standards, subject to various conditions. In late 1998, the legislature formally adopted many IASC standards as part of French group accounting law. The scale of requisite conversion and the various conditions attached to shifting from French accounting to either IASC or U.S. standards rendered these legislative efforts more an aspiration for liberalization, not its realization.

---

155 See Blake et al., supra note 5, at 22.
156 See Richard, supra note 10, at 1145–46.
157 See id.
158 See id. at 1146.
159 See id. at 1135–36.
160 Id.
161 Id.
162 One condition to adopting the alternatives is that the French CRC must adopt the law as regulation, which it showed reluctance to do. Among its concerns with respect to
French accounting traditionally was a highly regulated and uniform system, but business pressures of globalization and these legal developments change the picture, at least for multinational group accounts. The result is growing divergence within French accounting between individual and group accounting. Divergence also arises within group accounting, as differences grow between the literal requirements of group accounting and the group accounting produced in practice. Further fragmentation arises between group accounting practiced by multinationals, which approaches international standards, and group accounting practiced by domestic companies, which tends to adhere to traditional French accounting. These three strands of divergence are further complicated by the fact that all French legal change “is deeply rooted in a nexus of economic, political and social events.” Reactions to this anarchic condition in French accounting are diverse, varying with social groups. Leading commentators wonder whether French group accounting law is “heading towards regression, isolation or generalization.”

The divergence by French group accounting from its traditional individual accounting reflect how constrained French multinationals found themselves in contending with traditional French accounting. French industrial pressure to move toward

---

U.S. standards are the opposition by “many French specialists” to “the idea of using the standards of a foreign country.” Id. at 1136. The other two conditions are that the standards must (1) be translated into French (done or doable for IASC, far more complicated and yet to be done for U.S. GAAP) and (2) harmonize with EU standards (set forth in the Seventh and Fourth Directives), which is problematic in several ways. So far, it is impossible to comply with both EU and IASC standards. The solution of a company picking and choosing from one set or the other as a way to develop compliance with both is problematic in its own right, and also may not be permitted under IASC, EU, or French standards. Despite the efforts and movement, “influential members” of France’s CNC and CRC “began to lower the chances of the IASC to achieve its task of worldwide accounting harmonization.” Id.

163 See id. at 1136–37.
164 See id.
165 See id.
166 See id.
167 Id. at 1137.
168 Id.
169 Id. at 1139 (“[I]f the French accounting plan provided for individual financial accounts had been applied to group accounts, the French multinational would have found
more liberal group accounting began in 1966 when Rhône-Poulenc, Saint-Gobain, and Total adopted U.S. standards, leading France to develop formal group accounting rules two years later. But development was unsatisfactory, leading the COB (the French Bourse Commission) to permit using IASC or Anglo-Saxon standards, including U.S. GAAP. By this time, French group accounting for its 400 multinationals was in a state of "dreadful anarchy," using a blend of French, U.S., IASC, EU, and general international standards.

Europe's Seventh Directive furnished an occasion to harmonize French group accounting from its disorganized state. The result was a French legislative corpus on group accounts promulgated in 1985. Yet, French group accounting still lacks a "homogenous, economic-oriented legislation." In fact, instead of harmonization the legislation effectively codified two sets of rules, one for national groups and one for international groups. Differences are acute in the method of reporting expenses, using the traditional French total costs method for national groups and the cost of sales method for international groups. This "recourse to different methods" results "from the desire to permit national groups to go on applying traditional French practices while allowing multinationals to choose more international methods." This recourse is in default of global standards, a legislative punt to the demands of global stock markets to enable French
multinationals to compete in globalization.\footnote{Id. (absent global accounting standards, "the French legislator "has chosen to give French international groups great leeway in adapting to the peculiarities of the world's major stock markets.").}

Reactions to the evolution in French accounting are mixed.\footnote{Id. at 1145–46.} Applauding it are representatives of the big multinational companies and their French employees. Other experts "regret the trend of French accounting towards Anglo-Saxon models of financial statements," wishing instead for evolution along lines with individual accounts.\footnote{Id.} Another group is less bothered by the trend toward more economic principles of accounting but lament that French individual accounts were not being modified in the same direction.\footnote{Id.} One result of what has happened is individual accounts are still geared to state fiscal policies and taxation, whereas the group accounts sever the tax-accounting link and move to capital market-type accounting including adherence to a conception of the true and fair view more nearly in line with Anglo-American traditions.

A surprising consequence is that French multinational group accounting is even more dedicated to the true and fair view and its override mechanism than Anglo-American is—a striking departure from traditional French accounting which is seen as among the most rigid in the world.\footnote{Id.} The risk is the one Australia faced during the period it authorized the override—managerial opportunism—which led Australia to seal the override route in favor of the supplemental disclosure route.

\textbf{C. Struggle}

A third strategy to respond to the semiotic challenge may simply be described as struggling. Spain is illustrative. Spain’s Accounting Standards and Principles Commission announced in its Document No. 1 that the annual accounts must contain information to aid decision-making by users, including giving “a
true and fair view of the economic and financial situation of the company."182 Evincing a piquant common law outlook for a civil law (Romanic) nation, official Spanish accounting law elaborates that the concept “is not . . . fixed or delimited” but “tries to express the double notion of impartiality and objectivity.”183 Mixing traditions, the standard holds that a true and fair view will result from “systematic and regular application of accounting principles [but recognizes that these] will not be applicable in particular transactions [when] incompatible with a true and fair view.”184 Authority exists for both the override (Mandate 3) and the additional information approach (Mandate 2).185

Spanish accounting scholars are careful to emphasize that lest the Spanish interpretation appear “diaphanous,” the “existing confusion is in line with the disorientation at an international level.”186 Spanish scholars agree that a definition of true and fair is elusive and offer to respond to the challenge using two alternative interpretive strategies, epitomized elsewhere: “the legalist approach” of systematic application of the rules or the “economic approach” of fidelity to economic reality and elevating “substance over form.”187

The latter, in turn, can be met either by invoking the “supplementary character” of Mandate 2 (adding disclosure) or the “priority character” of Mandate 3 (overrides) and the choice concerning these is itself a choice invoking professional accounting judgment.188 This leaves ample room in practice for a wide variety of responses, from civil law traditions of adhering to the legalistic approach as sufficient to varying invocations of Mandates 2 or 3.189 The struggle continues.

182 BLAKE ET AL., supra note 5, at 19 (citing AECA, ACCOUNTING STANDARDS AND PRINCIPLES COMMISSION DOCUMENT No. 1 at 15).
183 Id. at 20 (citing Plan General de Contabilidad (Real Decree 1643/1990)).
184 Id.
185 Id.
186 Id. at 21.
187 Id.
188 Id. at 22 (citing Pereda J. Tua, Algunas precisiones adicionales en torno al principio de imagen fiel, TENICA CONTABLE 442 (1985)).
189 See id. at 22–24.
IV. Cash to the Rescue

If harmonization of the true and fair has been among the least successful ambitions of global accounting, one of its chief successes is establishing the statement of cash flows. The cash flow statement—a relative newcomer even to U.S. and U.K. accounting—transcends differences of accrual accounting in the United States and United Kingdom and is a fruitful place to transcend cross-border differences.190 It is through cash flow statements that the world can have her cake (harmonized accounting) and each country can eat it too (her own accounting).

The true and fair view requirement relates traditionally to the balance sheet and the profit and loss statement.191 The fierce trouble it causes is due to differences in the determination of income and measurement of assets across the world (not to mention within countries). Yet all major countries now agree that cash flow statements are integral to a full set of general purpose financial statements and all substantially agree on how it should be prepared. There are areas of debate, but these are minor in comparison to disagreements relating to the balance sheet and income statement.192 And the cash flow statement constitutes, ipso facto, a true and fair view—without need for defining or debating that concept’s meaning or how to achieve it.

The prospects for harmonization in the cash flow statement are

---

190 See Cooke et al., supra note 53, at 2668–69; Fischer et al., supra note 30, at 2975. Another major success is segment reporting—also relatively new in the history of accounting, in the United States and the world. It helps users deconstruct numerical information otherwise entangled in financial reports that are the product of different accounting rules. Cooke et al., supra note 53, at 2677–78; Fischer et al., supra note 30, at 2973–74.

191 See, e.g., Companies Act 1985, c. 6, § 226(2) (U.K.) (“The balance sheet shall give a true and fair view . . . ; and the profit and loss account shall give a true and fair view . . . .”); see also Christian Leuz, The Development of Voluntary Cash Flow Statements in Germany and the Influence of International Reporting Standards 3, at http://www.ssrn.com (Dec. 1999) (noting that HGB 264(2) and 297(2) require the true and fair view but that “Based on the legal commentaries, it is generally accepted that this requirement does not apply to a cash flow statement.”) (on file with the North Carolina Journal of International Law and Commercial Regulation); supra note 64 (quoting Dutch statute).

192 As discussed below, areas of disagreement are pretty much limited to matters at the borders of defining cash equivalents, classification of cash-related activities (as operating, investing, and financing), and methods or presentation (direct or indirect).
therefore great, if not a *fait accompli*.\textsuperscript{193} It is, thus, ironic that it is the one place to which the true and fair view has not been fully applied.\textsuperscript{194} Even SOX’s officer certification requirement does not apply to the cash flow statement. In its implementing regulations, however, the SEC extends the certification requirement to include the cash flow statement.\textsuperscript{195} This is notable because of all the components of a set of general purpose financial statements prepared in accordance with any accounting system, the cash flow statement is least affected by discretionary matters that implicate interpretive questions concerning true and fair—it is true and fair by definition, without regard to the definition. As notable, the proliferation of the cash flow statement was at least as much a product of market pressure as conscious harmonization efforts.\textsuperscript{196}

\textit{A. Utility}

Cash flow analysis and fair value accounting have assumed increasing importance in the past several decades, as theory and practice increasingly focus on cash generation as the ultimate result of productive activity, cash management as a measure of managerial prowess and cash-based valuation techniques as a key tool in corporate decision-making.\textsuperscript{197} Cash flow statements enable users to assess cash flow generation and absorption. That enables users to compare the present value of probable future cash flows

\textsuperscript{193} A 1998 survey of the 125 countries that are members of IOSCO found that eighty-two countries had adopted IAS 7 concerning statements of cash flows. Among those that had not were Australia and the United Kingdom, and both of these have cash flow statement requirements that do not vary radically from IAS 7. \textit{See Financial Times Survey Reveals Patchy Compliance with Interlational Accounting Standards}, 70 CPA J. 13 (2000).

\textsuperscript{194} \textit{See} LEUZ, \textit{supra} note 191, at 2 (noting that while German law does not apply the true and fair view requirement to the cash flow statement it “is viewed as generally sufficient to provide a true and fair view”).

\textsuperscript{195} Certification of Disclosure in Companies’ Quarterly and Annual Reports, 67 Fed. Reg. 57276, 57282 (Sept. 9, 2002) (proposed amendments to 17 C.F.R. pts. 228, 229, 232, 240, 249, 270, and 274). The rules explain the extension as “consistent with Congressional intent to include both income or loss and cash flows within the concept of “fair presentation” of an issuer’s results of operations.” \textit{Id}.

\textsuperscript{196} \textit{See} LEUZ, \textit{supra} note 191, at 5.

across different businesses.

For global harmonization quests, the cash flow statement promotes the comparability of reporting across varying accounting systems. The cash flow statement is unaffected by underlying accounting differences. Indeed, it consciously reverses any such differences. The lingering cultural disagreement concerning the statement is pretty much confined to defining cash equivalents that are included in the flow, a relatively modest issue, particularly compared to issues arising under traditional accounting principles across nations.

The standard cash flow statement format distinguishes among three sorts of cash flow: operating, investing, and financing. All are useful to any business, but each adds differential value to information depending on a company's life-cycle stage. For example, investing and financing cash flows add particularly valuable information concerning start-up and rapidly-growing businesses (those with fewer assets), whereas operating cash flows add particularly valuable information concerning mature or declining companies (those with more assets). The statement as a whole, thus, offers significant value across a range of businesses.

While most countries follow this three-part classification scheme, there is some variation. For example, the U.K. cash flow statement classifies activities into eight headings rather than three. On the other hand, the eight headings map reasonably

---

198 See Bernhard Grossfeld, Global Valuation: Geography and Semiotics, 55 S.M.U. L. REV. 197, 203–04 (2002). Professor Grossfeld elaborates: [It is globalization that makes cash flows more attractive than earnings as an international yardstick. Earnings are the result of many discretionary decisions that are tainted by different and often submerged cultural assumptions (consider depreciations or the setting up of hidden reserves). Cash flows can be measured objectively, as cash is cash in any money-oriented economy.]

Id.

199 See Richard, supra note 10, at 1206 (enduring issues tend to focus on the definition of cash equivalents).

200 Fischer et al., supra note 30, at 2785.


202 Cooke et al., supra note 53, at 2668.
well onto the more standard three-part approach.

The cash flow statement can be prepared using either the direct method or the indirect method.\textsuperscript{203} IAS and most countries permit the use of either.\textsuperscript{204} The United States recognizes both, and although it encourages using the direct method, most companies use the indirect method.\textsuperscript{205} The United Kingdom requires the indirect method and Australia requires the direct method.\textsuperscript{206} The disagreement is narrow, for the difference relates only to the portion of the cash flow statement relating to operating activities, not to investing or financing activities. Despite these differences, moreover, the direct and indirect methods are both seen as useful. Some evidence indicates that the direct method is more useful in that it has a superior relative ability to predict future operating cash flows.\textsuperscript{207}

The cash flow statement has also proven to be a more reliable tool (focused on cash flows) than traditional accounting tools (focused on balance sheets and income statements) in predicting bankruptcy filings under Chapter 11 of the U.S. Bankruptcy Code\textsuperscript{208} and insolvency generally.\textsuperscript{209} It can be a highly reliable

\textsuperscript{203} See Norvald Monsen, Cameral Accounting and Cash Flow Reporting: Some Implications for Use of the Direct or Indirect Method, 10 EURO. ACCT. REV. 705 (2001) (arguing that the debate centers on commercial double-entry bookkeeping systems and that this debate can be informed by single-entry cameral accounting used by governmental organizations and that this information supports using the direct method).

\textsuperscript{204} See Ordelheide, supra note 9, at 1428; Richard, supra note 10, at 1205; Kuroda, supra note 32, at 1866; Jan Klaassen, Netherlands: Individual Accounts, in 3 TRANSNATIONAL ACCOUNTING, supra note 13, at 2003.

\textsuperscript{205} FIN. ACCT. STANDARDS BD., STATEMENT OF FINANCIAL ACCOUNTING STANDARDS (SFAS) 95: STATEMENT OF CASH FLOWS, para. 27 (Nov. 1987).

\textsuperscript{206} Cooke et al., supra note 53, at 2668.


\textsuperscript{209} See Divesh Shankar Sharma & Errol R. Iselin, The Decision Usefulness of Reported Cash Flow and Accrual Information in a Behavioral Field Experiment, available at http://www.ssrn.com (last visited Mar. 23, 2003) (using actual bankers with at least three years of lending experience and finding that judgments based on cash flow information was statistically more significant than judgments based on accrual information and thus endorsing the call of regulators world-wide to mandate
gauge of business value, when used as a supplemental tool to analyze income statements and the effects of accruals.\textsuperscript{210} Indeed, institutional regimes ranging from the Delaware Court of Chancery to the World Bank endorse valuation methods using the discounted cash flow technique.\textsuperscript{211} Ultimately, cash flow is a fact, while earnings are an opinion—true across countries and within countries.\textsuperscript{212}

The cash flow statement cannot stand alone, of course. It is true that past cash flows are a better indicator of future cash flows than are earnings, but predictions can be improved by using the two together.\textsuperscript{213} On the other hand, evidence suggests that the cash flow statement is superior compared to the balance sheet for measuring accruals as a way to test for the presence of earnings management in the income statement.\textsuperscript{214} The cash flow statement is subject to negligible debate. Apart from minor and meaningless variance in the three-part classification, majority flexibility on using the indirect or direct method with some countries requiring one or the other, and minor definitional issues concerning cash equivalents, there is little up in the air. A few technical points arise, such as non-articulation between the cash flow statement and various balance sheet items, but none of these impairs either the value of the statement or its transcendent comparability.

Other debates center not so much on whether or how to prepare the cash flow statement, but how much information should be included on its face, such as measures of free cash flow, cash flow per share, and segment cash flow reporting.\textsuperscript{215} These are


\textsuperscript{213} Krishnan & Largay, supra note 207, at 241–43.


\textsuperscript{215} Cooke et al., supra note 53, at 2668.
matters mostly of determining what use can be made of the cash flow statement. Cash flow per share, for example, can be determined by a user easily from the statement and the balance sheet without regard to whether the preparer calculates it or whether a particular standard calls for it. The source of disagreement concerns the relative utility of the figure and whether it is considered reliable or potentially misleading in the hands of users. Thus, any quarrel is not at all with harmony in the cash flow statement. On the contrary, it reflects unanimity in recognizing that the cash flow statement is designed for users of financial statements—chiefly equity investors and not, for example, fiscal authorities.

B. Standing

Despite the importance of cash, the cash flow statement is a relatively new event.\(^{216}\) As of 1992, only the IAS and five countries—all Anglo-American—had articulated cash flow statement standards.\(^{217}\) Market forces began driving leading multinational companies in various countries to voluntarily prepare cash flow statements.\(^{218}\) The regulatory catalyst for global use of the cash flow statement was the 1994 decision of the International Organization of Securities Commissions to declare that the two, then-dominant standards (IAS 7 and U.S. SFAS 95) were equivalent; it anointed them with its seal of approval.\(^{219}\)

The cash flow statement evolved out of the funds flow statement, which became common in the 1970s and 1980s (though an early use in the United Kingdom dates to the financial statements of the Assam Company in 1862).\(^{220}\) But the funds flow statement focused on working capital. It did not encompass all

---

216 See LEUZ, supra note 191, at 6.
217 Id.
218 Id.
219 Simplification of Registration and Reporting Requirements for Foreign Companies, Safe Harbors for Public Announcements of Unregistered Offerings and Broker-Dealer Research Reports, 58 Fed. Reg. 60307 (Nov. 15, 1993) (release nos. 33-7029; 34-33139); see also Simplification of Registration and Reporting Requirements for Foreign Companies; Safe Harbors for Public Announcements of Unregistered Offerings and Broker-Dealer Research Reports, 59 Fed. Reg. 21644, 21646 (April 19, 1994) (release nos. 33-7053; 34-33918).
220 See Cooke et al., supra note 53, at 2668.
cash activities. It examined sources and application of funds that affected levels of balance sheet accounts, not all sources and uses of cash.

While the United Kingdom required a funds flow statement beginning in 1975, it did not require a cash flow statement until 1990. Indeed, the first act of the newly-constituted U.K. Accounting Standards Board was the publication of Financial Reporting Standard 1, Cash Flow Statements (FRS 1). It was inspired by a macroeconomic recession accompanied by a wave of business failures.

The ASB subsequently revised FRS 1 to define more clearly what constitutes cash equivalents, adopting FRS 10 in 1994 reflecting the revisions and a further issuance in 1996. FRS 1 announces that the purpose of the cash flow statement is to assist users in assessing the company’s liquidity, viability, and financial adaptability. Specifically emphasized is the virtue of enabling a user to compare different businesses. The original United Kingdom adoption of the cash flow statement as a response to business failures suggests properly that an important function of the statement is to reveal credit quality and liquidity, precisely the sorts of concerns at the forefront of Germanic and Japanese accounting and an important concern of French accounting.

Germanic use of cash flow or funds flow statements (called KapitalfluBrechnungenis) are of recent vintage. In 1988, only ten of the 100 largest German companies reported a funds flow statement and only some of these disclosed cash flow figures and none of 150 medium-sized companies did so. By 1995, the year the German HFA endorsed cash flow statements, nearly three quarters of the sixty-five largest German companies included full cash flow statements.

---

221 Id.
222 Id.
223 Id.
224 Id.
225 See id.
226 Ballwieser, supra note 28, at 1333.
227 Id.
228 See generally LEUZ, supra note 191, at 2 (also presenting the results of an extensive multivariate study examining the evolution of cash flow statement use in
The German legislature in 1998 amended the Corporate Code to require a cash flow statement. It specifies no particular requirements. Since it was prompted by globalization, German accountants understand that the required cash flow statement is that prescribed by IAS 7 (or SFAS 95). German business and accounting professionals adopted recommendations along substantially these lines, though with some minor variation in the design of the statement. The adoption and use of the cash flow statement in Germany is uncontroversial—in striking contrast to the true and fair view.

Cash flow statements are not part of traditional French accounting, and French law does not require cash flow statements for individual accounts. The initial move towards cash flow statements followed the typical path that began with using a funds flow statement. It was quickly seen as outdated, analyzing only movements in working capital, and was replaced with a full cash flow statement. The current requirement, adopted for group accounts in 1999, follows SFAS 95 with minor differences. It constitutes a “progressive alignment” of French and Anglo-Saxon accounting theory.

French accountants underscore the significance of the cash flow statement by noting: “the preponderance of cash problems in today’s financial management, the need of objective information, the evolution of international practice.” Nearly all of France’s

---

229 Ballwieser, supra note 28, at 1333–34 (citing HGB § 293, ¶ 1). The cash flow statement requirement applies to individual and group accounts (HGB § 297, ¶ 1 extends the requirement to group accounts). Id.

230 Id. at 1334.

231 Id. (citing Schmalenbach-Gesellschaft and the German Institute of Chartered Accountants—SG/HFA 1/1995).

232 Id. (“there does not exist any controversial viewpoint concerning the purposes of cash flow statements. . . .”).

233 Gélard, supra note 138, at 1108.

234 Id.

235 Id.

236 Richard, supra note 10, at 1204–05.

237 Id. at 1205.

238 Id.
largest 100 corporate groups publish cash or funds flow statements, and the percentage using the old funds flow statement is steadily declining in favor of using the cash flow statement.\textsuperscript{239}

Japanese corporations began using statements of cash flows in 1987, though at the time it was seen as an adjunct to the financial statements and not subject to audit.\textsuperscript{240} Since 1999, Japanese law requires the statement, as an integral part of the financial statements.\textsuperscript{241} An accompanying official statement specifies the purpose of the cash flow statement as revealing the generation and absorption of cash, including cash equivalents.\textsuperscript{242} It follows the universal cash flow formatting principles of IAS 7 and other countries, including not only the United States, United Kingdom, Germany, and France, but also the Netherlands, Australia, Spain, and a hundred others.\textsuperscript{243} Cash is king, emperor of global accounting, putting global angst over the true and fair view in the distant dust of matters of greatest promise and payoff.

C. Next Steps: Toward A Conclusion

The promise of the cash flow statement for global accounting is substantially being realized. Final steps to completion are the following. First, the remaining one-third of IOSCO member countries not having signed onto IAS 7 should do so. This includes the United Kingdom and Australia. Second, agreement must be reached—especially with the United Kingdom—on the three-part classification, and the United Kingdom must be persuaded to move from its eight-part classification or perhaps include both. Third, agreement must be reached concerning the use of direct or indirect method. For the United Kingdom and Australia, adoption would mean permitting either. Better yet, other members could agree to mandate one or the other—there seems to be substantial agreement among users that the direct method is more useful though corporations at least in the United States have preferred to provide the indirect method. Fourth, agreement must be finalized concerning the definition of cash

\textsuperscript{239} Id. at 1206.
\textsuperscript{240} Kuroda, supra note 32, at 1857.
\textsuperscript{241} Id. (citing Articles 8-2 and 76 MOF Consolidation Regulations).
\textsuperscript{242} See id. at 1858.
\textsuperscript{243} Id.
equivalents, a modest but useful loop to close. Fifth, and more a project for users than preparers, is to develop a more uniform catalogue of the uses to which cash flow statement analysis can be directed. Issues include the extent to which such figures as cash flow per share or quality of income should be emphasized as reliable or labeled with caution as potentially misleading.