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## Common Roots of the European Law of Accounting

Bernhard Grossfeld

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## Common Roots of the European Law of Accounting

Sir Joseph Gold's lifetime work was devoted to the law of money (currencies) and exchange controls—both highly specialized fields. It is not easy for a law professor in more general fields to build a bridge of common interests. The law of accounting appears to be closest to these fields, as money and accounting both have to do with numbers.

Europe is coming more closely together. German and English laws formed the foundation of the new European law of accounting—but can they continue together in the future? The English concept of true and fair view has just started to infuse the European accounting world, but does the concept of fairness mean the same in both legal cultures? Or does the same notion carry with it different contexts? Is the similarity in name only or in substance as well? These are serious questions in comparative law and they are often overlooked by noncomparativists. Yet the Shakespearean “words, words, words”<sup>1</sup> cannot be the last word in comparative law, nor in comparative accounting.

### I. Differences

When it comes to substance, how great are the possible differences? Is there a chance to bridge the gap? That depends on its width. The most efficient means to evaluate the width of the gap is the study of the common history. But is there a common history? We cannot approach this question by looking only at the rules of accounting. They are only part of the wider cultural and business law contexts that color the features of the individual rules.

Answers are often pessimistic. It is often said that English law is different; or that German law is different! Yet, how different is English law from German law really? The general feeling is characterized by two general statements: Your law

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\*Professor, Institut für Internationales Wirtschaftsrecht, Universität Münster, Federal Republic of Germany.

1. Shakespeare, *Hamlet*, II, 2.

is codified; our law is based on precedents. I doubt that these remarks are true. Look first at the English statutes at large: Are there fewer statutes in England than in Germany? Are English statutes less extensive or less intricate? Statutes are products of modern parliaments and the parliaments of Great Britain and Germany are similarly active. Also look at the French experience, for there we find the Code Civil of 1804: This Code Civil treats the law of torts in only three paragraphs.<sup>2</sup> From there the French lawyers developed many new concepts, such as assumption of risk, strict liability, and product liability. I once heard a French lawyer saying "We always treat the Code with great respect but we do not take too much care of it." After all, the Code Civil, dating from 1804, is less than 200 years old, and the German Bürgerliches Gesetzbuch, dating from 1896, is less than 100 years old. Is it fair to believe that these 200 years changed the whole structure of the legal culture?

Let us turn now to the precedents thesis. To make a complicated story short, while in theory the differences are quite substantial, the practice is almost the same in both countries. In practice, German courts tend to follow the higher courts to almost the same extent as do their English counterparts. Thus, if these two sentences do not reflect reality, what then are the differences between English and German law? The answer is easy: These two laws are as different from each other as English culture and English history are from German culture and German history. Law expresses common history, the common subconscious of a people in a given country.

## II. Interrelations

How different are the two cultural histories? There was a time when England, living in splendid isolation, was regarded as being quite set apart from the Continent. But when viewing the matter more carefully, the picture gets very shaky. There were always tunnels and bridges for commerce and ideas across the Channel—long before the Chunnel idea saw the light of the day.<sup>3</sup> This is already apparent when the similarity in style between the cathedrals on both sides of the Channel are considered, in addition to the links that are indicated by words: wool cathedrals, wool merchants, Flandrian clothes, and the Hanseatic Union (of which Münster was a member). The finest example is the abbreviation of the British pound (£), derived from libra, an Italian expression. There must have been strong economic and legal influences from the Continent, especially from Northern Italy, the business center of the Middle Ages. There was a time when scholars thought English law was a legal culture all of its own; Roman law never came into England, it was said. Yet, like most adages, this is only partially true. Bracton's *On the Laws*

2. CODE CIVIL [C. CIV.] arts. 1382, 1383, 1384 (Fr.).

3. Gorla & Moccia, A "Revisiting" of the Comparison between "Continental Law" and "English Law" (16th–19th Century), 2 AM. J. LEGAL HIST. 143 (1982); Kessler, *Metamorphosen im Amerikanischen Vertragsrecht*, 43 JURISTENZEITUNG 109 (1988); Moccia, *English Law Attitudes to the Civil Law*, 2 J. LEGAL HIST. 157 (1981).

of England, dating from the thirteenth century, cites extensively the "Glossa Ordinaria" by Accursius, the leading Roman law source at the time.<sup>4</sup>

We know by now that the main engine for the introduction of the Roman law to England was the canonical law. It filtered the Roman law ideas and gave them rebirth as Christian natural justice. The influence of the canonical law was as strong in England as it was on the Continent. Was not the English Chancellor always a clergyman? The answer again, is clear: England was and is part of a common European law that governed all Europe until the beginning of the nineteenth century when, unfortunately, the English-French conflict during the Napoleonic wars and the growth of European nationalism interrupted long-standing economic, cultural, and legal relations.

To mollify the audience, however, not only did the Continent conquer England, the British conquered Europe as well.<sup>5</sup> Two examples illustrate this point: The income tax is an English invention; it was invented by William Pitt at the end of the eighteenth century. On January 9, 1799, Pitt's initiative resulted in the first income tax statute in history.<sup>6</sup> The fame of this income tax soon spread to the Continent. The Germans eventually adopted and developed the income tax so thoroughly that they regarded it as their own: "What the English sister began, the German sister has completed."<sup>7</sup> It was Prussia in particular that followed the English example.<sup>8</sup> At that time, Prussia formed a coalition with England against Napoleon. The Prussians were eager to get the same financial weapon from the English that had proved to be so successful in the war against Napoleon.

The influence of English corporation law on German corporation law was equally strong. The liberalization of Germany's corporation law in 1870 cannot be explained without its English counterpart. Adam Smith was one of the most important persons on the Continent during the nineteenth century. The liberal approach towards corporations cannot be seen without his ideas on free markets and free trades.<sup>9</sup> Thus, we have not only strong common roots, we have also a strong history in common that is not always adversarial in nature.

### III. Common Values

This community of values, outlooks, and legal techniques found a striking expression when I once had to lecture in New York on the interpretation of

4. HENRY DE BRACON, *DE LEGIBUS ET CONSUETUDINIBUS ANGLIAE* (1240).

5. Coing, *Europäische Grundlagen des modernen Privatrechts*, in *VIER VORLESUNGEN AUS DER EUROPÄISCHEN FORSCHUNG* (1987).

6. S. FRANKE, *ENTWICKLUNG UND BEGRÜNDUNG DER EINKOMMENSTEUER* 9 (1981).

7. B. GROSSFELD, *DIE EINKOMMENSTEUER* 10 (1981) [hereinafter *DIE EINKOMMENSTEUER*]; B. GROSSFELD, *MACHT UND OHNMACHT DER RECHTSVERGLEICHUNG* 39 (1984) [hereinafter *MACHT*]; Grossfeld & Bryce, *A Brief Comparative History of the Origins of the Income Tax in Great Britain, Germany and the United States*, 3 *AM. J. TAX POL'Y* 211, 214 (1982).

8. *DIE EINKOMMENSTEUER*, *supra* note 7, at 27.

9. B. GROSSFELD, *AKTIENGESellschaft, UNTERNEHMENSKONZENTRATION UND KLEINAKTIONÄR* 136 (1968).

statutes.<sup>10</sup> My point was that before talking about interpretation we should talk first about what a "statute" is in different legal cultures. (The question is also important for purposes of our present discussion.) At the end of the class, a young lady stood up and said with emotion, "Mr. Grossfeld, I have always felt I was British; after having been in New York for six months I know I am European." Isn't that a lovely start and a good reason for optimism for any discussion on European accounting? We are all Europeans! You might laugh and you might think: "Now Mr. Grossfeld, isn't your concept [if you are polite] a little bit or [if you are honest] too broad and too farfetched to be of any help when it comes to the hard questions, the concrete issues?" Am I a typical comparatist, always seeing the grand design and missing the problems of the day? For an answer then, let us turn to the concrete questions of history with regard to rules of accounting.

#### IV. Northern Italy

At the beginning we encounter what we found to be the basis of the European common law in general: Northern Italy.<sup>11</sup> Look at the word "accounting," which means *a conto* in the Italian thirteenth century; remember also Shakespeare's *The Merchant of Venice*. The connection with basic features of European culture, however, goes even deeper. The European accounting system is a consequence of the Arab numbers that came into Northern Italy in the course of the thirteenth century.<sup>12</sup> The spread of accounting techniques from there all over Europe was extensive, both in speed and depth: A new light, in the tradition of Bologna and Pisa, conquered Europe. The work of the Franciscan monk Luca Pacioli from 1494 became the accounting "bible" for Europe.<sup>13</sup> The interrelation with modern mathematics is evident by the five chapters of his book: (1) Arithmetic and algebra in general; (2) Arithmetic and algebra for merchants; (3) Accounting; (4) Currency, measurements and weights; and (5) Pure and applied mathematics. Thus, accounting techniques are an expression of the old and new European mind. Geometrically and mathematically regulated, it is a way to see the world "more geometrico" or in a geometrical way. *This* is our common European heritage in business and science that spills over into everything. The concept of

10. Frankfurter, *Some Reflections on the Reading of Statutes*, in LANDMARKS OF LAWS 210 (R. Henson ed. 1960).

11. Grossfeld & Diekmann, *Gemeinsame Grundlagen des Europäischen Bilanzrechts*, 41 DIE WIRTSCHAFTSPRÜFUNG 419 (1988).

12. J. CAREY, THE RISE OF THE ACCOUNTING PROFESSION 14 (1969); Käfer, *Berner Kommentar zum Schweizerischen Privatrecht*, in 8 DIE KAUFMÄNNISCHE BUCHFÜHRUNG 2. Abteil. 1. Lieferung, at 9 (1976); Rehme, *Geschichte des Handelsrechts*, in 1 HANDBUCH DES GESAMTEN HANDELSRECHTS 28, 98 (V. Ehrenberg pub. 1913).

13. L. PACIOLI, SUMMA DE ARITHMETICA, GEOMETRIA, PORPORTIONI ET PORPORTIONALI (1494), in *Abhandlungen über die Buchhaltung* 11 QUELLEN UND STUDIEN ZUR GESCHICHTE DER BETRIEBSWIRTSCHAFTSLEHRE 51 (B. Penndorf German trans. 1933).

the "bible" from Luca Pacioli was soon transferred to Flanders, France, and of course, to England in 1543 by Oldcastle.<sup>14</sup>

## V. France

In the seventeenth century, France took the lead through the Ordonnance de Commerce from 1673. Aha, you might think, finally we arrive at the fundamental differences and the statute takes the lead. But there is no rupture with the common tradition or with common values here. It is only an expression of the fact that the absolutism of the kings was successful on the Continent, yet unsuccessful in England where the English beheaded King Charles in 1649. The Continental parliaments later took the position of the absolute kings. This explains some of the differences in statutory interpretation between the Continent and England until today. It is, however, a difference more in form than in substance. For me it is clear that the Code Savary, as the Ordonnance was called, expressed the common European rules at the time, not the particular French ideas of absolutism. There is a hint in Savary's personal history that this European view included England because Savary worked in the textile business.<sup>15</sup> Was not that *the* subject of trade between England and the Continent in those days? Bruges and Ghent were not only centers for the European trade, they were likewise centers for the development of rules of accounting that radiated from there to France and England alike.<sup>16</sup>

Savary's book *Le Parfait Négociant* (the perfect merchant) is *the* commentary for the Ordonnance.<sup>17</sup> There we find rules concerning the evaluation of assets and warnings against regarding oneself too rich or showing profits that have not yet been realized on the market. Savary favors the purchase price method.<sup>18</sup>

## VI. Germany

From Savary a straight line runs to the Code Napoleon and in Germany to the Preussische Allgemeine Landrecht from 1794, Prussia's Common Law of the Country. We find the purchase price principle, the lowest value method, and rules of depreciation.<sup>19</sup> But law is shaped not only by tradition, it is shaped also by new technical developments. The new technical developments we are concerned with are known as the industrial revolution. The accumulation of capital for new industries accounts for the fact that enterprises have a longer lasting life, that they

14. L. PACIOLI, *supra* note 13, at 74. See generally Käfer, *supra* note 12, at 11.

15. ter Vehn, *Die Entwicklung der Bilanz bis zum Allgemeinen Deutschen Handelsgesetzbuch*, 6 ZEITSCHRIFT FÜR BETRIEBSWIRTSCHAFT 241, 242 (1929).

16. G. POST-PAWELLECK, *GESCHICHTE DES ENGLISCHEN BILANZRECHTS* (1989).

17. See generally Käfer, *supra* note 12, at 60; Rehme, *supra* note 12, at 183.

18. 1 J. SAVARY, *LE PARFAIT NÉGOCIANT* 323 (1797).

19. 1 K. BARTH, *DIE ENTWICKLUNG DES DEUTSCHEN BILANZRECHTS* 268 (1953); See generally Käfer, *supra* note 12, at 60.

tend to eternity.<sup>20</sup> The invention of the share company with its legal immortality stand for this proposition. The impact on accounting is dramatic. The annual balance sheet becomes the norm rather than the exception. The mathematical-geometrical method moves over into time; the aspect of time becomes paramount in accounting and periodization is now the name of the game.<sup>21</sup> The problem of evaluation at a certain date steps into a central position.<sup>22</sup> Only now do Savary's ideas on evaluation find widespread practical application on the Continent and, I suppose, in England.

I do not want to elaborate too deeply on the subsequent developments in Germany. It should be mentioned, however, that it was not until 1884 that the concept of purchase price and production cost was accepted in all Germany. The great financial crash in the early seventies had proved the unreliability of other methods, in particular the resale price method.<sup>23</sup>

## VII. England

Looking now at England, I think we can be assured that the common European ideas on accounting were as strong in England as the common European law was in general. I have already mentioned that different political developments with regard to the structure of government and parliament and the predominant position of London caused different ways of pronouncing these rules. The common-law approach in general was applied to rules of accounting. Beside this, the island character prevailed and a homogenous, closely knit group in London took the lead. The auditors as a professional body became the trustees for the rules of accounting, in particular after 1862 when Parliament introduced a compulsory yearly examination of companies' books.<sup>24</sup> This set the pattern for similar developments in Germany since 1931.<sup>25</sup> The German public accountants owe their position to their English colleagues!

## VIII. Island versus Continent

The preceding historical sketch illustrates that a shared values approach might be feasible and existing hurdles might be overcome. By the same token, we should not close our eyes concerning the real differences in our legal cultures.<sup>26</sup> When we compare England with the Continent one factor stands out: England is

20. See generally B. GROSSFELD, *supra* note 9, at 5.

21. See generally K. BARTH, *supra* note 19, at 51.

22. See generally K. BARTH, *id.* at 55, 56; C.S. GRÜNHUT, *Das Recht der Dividende*, 1 GRÜNHUT'S ZEITSCHRIFT 375, 384, 387 (1874).

23. Alsheimer, *Von der Gründerkrise zum Zusammenbruch der Frankfurter Allgemeine-Versicherungs-Aktiengesellschaft*, 41 DIE WIRTSCHAFTSPRÜFUNG 471 (1988).

24. See generally K. BARTH, *supra* note 19, at 221.

25. See DEUTSCHES HANDELSGESETZBUCH [HGB] § 262a.

26. Grossfeld, *Geography and Law*, 82 MICH. L. REV. 1510, 1511 (1984).

an island. This island character of her legal culture and the early centralization of all important factors in London provides a very close business society, an old-boys network almost all members of which share a common educational background (Oxbridge).<sup>27</sup> In addition, England enjoys an almost unbroken tradition of nine hundred years with practically no tumultuous interruptions from outside, such as for instance, the hundred years' war in France, the thirty years' war in Germany, or other European wars.

In a closely knit and relatively stable society, many things go without saying and without positive law; they exist just by tacit mutual understanding and by direct social control. The term "fair" needs no legal interpretation because everybody knows what it means. What to do or not to do needs no elaborate positivism as it may need in other European countries such as Germany. Such regulatory systems cannot easily be transferred to other cultures, where one finds different "players" who do not know the intricate rules of the game or the tacit sanctions against taboo-breakers.

### IX. Interpretation of Statutes

Another difficulty may arise from a different approach towards statutes. We know already that the English tend to interpret statutes as narrowly as possible, whereas on the Continent statutes are construed more broadly. Here again, we should not overestimate these differences as, apparently in the interpretation of European laws, the two cultures move in similar directions. However, it may well be, that article 2, sections 4 and 5 of the Fourth Directive only relate to the English technique to construe a statute, whereas they do not add much to the Continental mode of interpretation. It may turn out that the English "true and fair view" is just a means to bring English techniques of interpretation in line with Continental traditions, which in turn govern the interpretation of the EEC rules. Another difference may lie in the fact that the study of law has long been regarded as a "science" on the Continent that was taught on the university level and handled by learned lawyers. The long prevailing jury system in England is in stark contrast to this tradition.

### X. Search for Common Features

To say it frankly, I do not believe that these differences are strong obstacles, if there is a common will to overcome them. So far, European scholars have spent too much energy to see the differences in another culture and to paint the other legal system as exotic as possible because the more exotic, the more applause for the adventurous explorer. In comparative law, one should start, however, at the other end. For example, what do we have in common, where are the bridges,

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27. MACHT, *supra* note 7, at 88.



even weak ones, over which we might cross? The search for common features is a solid basis for comparative studies. The bridges and tunnels over and under the Channel are, I believe, sufficiently strong for a face-to-face encounter as the only way to reach reality in comparative law. Not "words, words, words."<sup>28</sup>

## XI. Outlook

St. John, the evangelist, begins with "In the beginning was the word,"<sup>29</sup> but at the original end of his evangelism he introduced Thomas, the unbeliever.<sup>30</sup> Thomas wanted to touch the reality; only that made him believe. Seeing and feeling is believing. The longer I think about it the more this Thomas appears to be the patron saint for comparative lawyers. In the search for social reality, this is what law and comparative law are all about. As a last example to support this proposition, the Slavistic word "prawda" means "truth" in Russian and "justice" in Bulgarian. Is there a better explanation for the feeling that "true and fair" belong together, a common European heritage as expressed by languages? Not only by the Slavistic language, but also by our own languages: "You are right," "Du hast recht," reality and justice go together. I believe that an awareness of common roots may help us not to regard other's views as somewhat exotic, but rather as a different way to reach similar objectives.

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28. Shakespeare, *supra* note 1.

29. *John* 1:1.

30. *John* 20:24-29.