Taxation, Accounting and Transparency: The Missing Trinity of Corporate Life

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1. Introduction

Without doubt, taxation is one of the most powerful motivational forces in corporate life. Tax consequences are important determinants of capital structure, dividend payments and the arrangement of groups of companies, amongst many other things. In view of this, it seems quite surprising that codes of "good" corporate governance promulgated in many European countries during the past years typically do not mention taxation explicitly.

There are various possible explanations, all of which remain speculative. First, the issue of taxation may be too complicated for the addressees. Members of the supervisory board or non-executive directors will typically leave issues of tax planning to the firm's managers, as these are much better informed about available opportunities. This confirms the statement in the contribution to this conference by Pekka Timonen that "taxes are recognized merely as a standard cost related to profits, the specialty of which is that it is sometimes avoidable or at least possible to reduce by tax planning." Second, as corporate governance codes are designed as signals seeking to attract investment (typically from abroad), any references to a corporation tax obligation under national law may confuse or even deter foreign investors.

Third and most of all, the discussion of issues of taxation in a firm's publicly disclosed corporate governance report may attract the unwanted attention of tax authorities. Still, taxation has important implications for corporate governance and should not be overlooked by board members or investors.

2. The Shifting Corporate Governance Paradigm

The conception of corporate governance has changed in a remarkable way in the last fifteen years in continental Europe. In countries such as Germany and Austria, the corporation used to be perceived as a "business as such" (*Unternehmen an sich*), *i.e.* an entity with its own legal existence and goals irrespective of the interests of the members of the underlying business association.[1] More recently the corporation's

* The author would like to thank Martin Gelter for his valuable assistance.

[1] *See* RATHENAU, Vom Aktienwesen – Eine Geschäftliche Betrachtung (1917); HAUSSMANN, Vom Aktienwesen und vom Aktienrecht (1928). Rathenau believed that the interests of long-term stockholders, managers and the public where largely coherent and had to be protected from the interests of short-term speculators. For a historical overview *see e.g.* GROßMANN, Unternehmensziele im Aktienrecht, 141 *et seq.* (1980).

"*Unternehmensinteresse*" has been understood as the amalgamation of the interest of various stakeholders.[2] This view is of course intimately linked to the longstanding influence of large shareholders, creditors, employees, and in some cases the government representing the "public interest", which was realized either through legal rules, or through formal or informal systems of influence, such as codetermination or the practice to appoint bank representatives to the board.[3]

At least in academic circles and on the surface of corporate rhetoric, this view has to some degree succumbed to the pressure of capital markets. Although many aspects of continental corporate governance systems have remained intact (including the presences of large blockholders, codetermination and the bulk of legal rules), corporate law is increasingly seen as an instrument to attenuate the agency problem between investors on the one hand and managers and large shareholders on the other hand. More often than in the past, managers publicly emphasize the importance of creating shareholder value, and legal scholars have begun to ask whether a commitment to shareholder value is compatible with (or can replace) the traditional doctrine of *Unternehmensinteresse*.[4] Some have observed changes in German corporate governance practices[5] or the unwinding of concentrated ownership structures.[6]

Two aspects of this development, which is linked to corporations' increased reliance on capital markets,[7] are the "Codes of Corporate Governance" movement, and the demand for more transparent accounting, which has led to a convergence with Anglo-Saxon standards and practices.[8]

3. The Shifting Accounting Paradigm

Continental accounting has moved towards more transparency in recent years. German (and Austrian) accounting has long rested on the traditional "principles of proper bookkeeping" (GoB) and, beginning with the German AktG of 1965 and the implementation of the Fourth EC Company Law Directive of 1978 (Accounting Directive)[9] and the Seventh EC Company Law Directive of 1983 (Consolidated

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[2] *See e.g.* ZÖLLNER, in: ZÖLLNER (ed.), Kölner Kommentar zum Aktiengesetz, Einleitung, notes 129-136 (1984).

[3] On the composition of German supervisory board, *see e.g.* HOPT, The German Two-Tier Board: Experience, Theories, Reforms, in: HOPT/KANDA/ROE/WYMEERSCH/PRIGGE (eds.), Comparative Corporate Governance – The State of the Art and Emerging Research, 227, 245-249 (1998).

[4] *See e.g.* MÜLBERT, Shareholder Value aus rechtlicher Sicht, 1997 Zeitschrift für Gesellschafts- und Unternehmensrecht 129.

[5] CHEFFINS, The Metamorphosis of "Germany Inc.": The Case of Executive Pay, 49 Am. J. Comp. L. 497 (2001).

[6] WÓJCIK, Change in the German Model of Corporate Governance: Evidence from Blockholdings 1997-2001, 35 Env't & Plan. A 1431 (2003).

[7] CROMME, Corporate Governance in Germany and the German Code of Corporate Governance, 13 Corp. Governance 362, 362-363 (2005).

[8] HERTIG/KRAAKMAN/ROCK, Issuers and Investor Protection, in: KRAAKMAN *et al.* (eds.), The Anatomy of Corporate Law, 193, 201-202 (2004).

[9] Fourth Council Directive 78/660/EEC of July 25, 1978, based on Article 54(3)(g) of the Treaty on the Annual Accounts of Certain Types of Companies, arts. 2(3), 47(1), 1978 O.J. (L 222) 11.

Accounts Directive),[10] on extensive statutory regulation. These European Directives were historically strongly influenced by the previous German law.[11]

During the 1990s, the demand for accounting standards tailored to the needs of capital markets rose, and criticism of traditional accounting law began to mount. A larger number of critics began to argue that the accounting regime of the Directives, and more specifically, national accounting systems such as the German or Austrian ones, did not provide adequate transparency, in particular with a view to the informational needs of the participants of international capital markets.[12]

At the same time, the continental focus on conservatism, or prudence, came under attack, as an increasing number of practitioners and scholars found that the link between conservative accounting, capital maintenance and the (reverse) principle of authoritativeness and the use of financial statements as the tax base led to a distortion of the "true and fair view",[13] which financial statements were actually supposed to convey to an educated and informed reader.

The laws of several Member States were brought into line with this trend by allowing some (or all) parent firms to use "internationally recognized accounting standards" for their consolidated accounts (as long as they were compatible with the 7th Directive).[14] In 2002, the EU reacted by passing the IAS Regulation,[15] which requires listed companies to use IAS/IFRS in their consolidated accounts since 2005, but also permits Member States to require or allow (some or all) firms to use IFRS for consolidated accounts and even individual accounts. Several countries have implemented these options by either allowing or even requiring certain or even all

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[10] Seventh Council Directive 83/349/EEC of June 13, 1983, based on Article 54(3)(g) of the Treaty on Consolidated Accounts, arts. 16(3), 38(6), 1983 O.J. (L 193) 1.

[11] *See* generally NOBES, The Evolution of the Harmonising Provisions of the 1980 and 1981 Companies Acts, 1983 Acct. & Bus. Res. 43; EVANS/NOBES, Some mysteries relating to the prudence principle in the Fourth Directive and in German and British law, 5 Eur. Acct. Rev. 361, 363 (1996).

[12] HALLER, Financial accounting developments in the European Union: past events and future prospects, 11 Eur. Acct. Rev. 153, 160-168 (2002).

[13] Art. 2(3) of the Fourth Directive.

[14] *E.g.* HGB (Germany) § 292a, as amended by the Gesetz zur Verbesserung der Wettbewerbsfähigkeit deutscher Konzerne an internationalen Kapitalmärkten und zur erleichterten Aufnahme von Gesellschafterdarlehen (Kapitalaufnahmeerleichterungsgesetz) [Law to Improve Competitiveness of German Groups of Companies in International Capital Markets and to Facilitate the Acceptance of Shareholder Loans], April 20, 1998, BGBl I, at 707 (F.R.G.); HGB (Austria) § 245a, as amended by Bundesgesetz über Änderungen des Handelsgesetzbuches, des Bankwesengesetzes, des Wertpapieraufsichtsgesetzes und des Versicherungsaufsichtsgesetzes betreffend die Anwendung international anerkannter Rechnungslegungsgrundsätze bei Konzernabschlüssen – Konzernabschlußgesetz [Law on Consolidated Financial Statements], March 26, 1999, BGBl 1999 I/49 (Austria).

[15] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of July 19, 2002, 2002 O.J. (L 243) 1.

firms to use IAS/IFRS for their individual accounts.[16] Others, such as France, Germany and Austria, allow IFRS only for consolidated accounts.

For Member States, the crucial policy question underlying this choice is what conception of a link between financial accounting on the one hand and capital maintenance and corporate taxation on the other hand they intend to pursue. The shifting accounting paradigm raises the question whether the traditional accounting system, which has traditionally emphasized prudence in German-speaking countries,[17] should be replaced by IFRS also for individual accounts, and whether the system of conservative accounting should be abandoned altogether.

4. The Link between Prudence, Capital Maintenance and Taxation

In German-speaking countries, accounting standards have traditionally been codified by statute, and have been intimately linked to both capital maintenance and taxation. With respect to capital maintenance, this connection has made its way into the first generation of European Company Law Directives. Art. 15(1)(a) of the Second Directive[18] provides that "[…] no distribution to shareholders may be made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are, or following such a distribution would become, lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes."

Since corporations may not distribute their stated capital, and since distributions are limited to accounting profits, financial accounting (*i.e.* the firm's individual accounts) forms the basis of the computation of the amount of profits that can be distributed to shareholders. The emphasis of prudence in accounting has long been considered an important element of the capital maintenance and therefore creditor protection system, both under national law and the Directives. While revenues may only be shown when they are "made" (Art. 31(1)(c)(aa) of the Fourth Directive) or "realized", adequate provisions must be recognized for probable expenses. Naturally, this leads to the question when revenues can be considered to have been "realized". The traditional view requires the transaction to be in a relatively late state of performance, *i.e.* when the firm had already done everything to obtain the claim.[19] By contrast, in the case of a liability or a contingent liability, the traditional position was to

[16] A survey published by the European Commission (Planned Implementation of the IAS Regulation in the EU and EEA, May 15, 2006) lists 11 EU and EEA countries permitting IAS for the annual accounts of all firms and two countries (Cyprus, Malta) requiring them. Besides these, Germany allows the use of IAS for information purposes only (HGB § 325(2a) [Germany]).

[17] *See e.g.* EVANS/NOBES, *supra* note 11; VAN HULLE, Prudence: a principle or an attitude, 5 Eur. Acct. Rev. 375 (1996) (both comparing the British and German attitude towards prudence in accounting before the backdrop of the Fourth Directive).

[18] Council Directive 77/91/EEC, Second Company Law Directive, Art. 1, 1977 O.J. (L 26) 1.

[19] *See e.g.* PELLENS/SELLHORN, Improving Creditor Protection through IFRS Reporting and Solvency Tests, in: LUTTER (ed.), Legal Capital in Europe, 365, 372 (2006); FERRAN, The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union, 3 Eur. Company & Fin. L. Rev. 179, 209-210 (2006).

show a loss rather early than late. Creditors were therefore supposedly protected because rather less than more liquidity could be transferred to shareholders.

Capital maintenance has come under attack for entirely different reasons during the past years. With *Centros* and subsequent cases of the ECJ,[20] at least in some countries, including Germany, a wave of new foundations of firms has emerged, whose founders decided to use English Limited Liability companies instead of the GmbH,[21] partly because of the absence of a minimum capital requirement in the latter. This led to a discussion on the current regulatory framework and a surge of literature. As a result, we may see the end or fundamental transformation of the capital system during the coming years. However, even if the legal capital system were to remain in place as it is, it would be undermined by the use of IFRS in individual accounts, unless such a reform was coupled either with the requirement to create non-distributable reserves corresponding to the amount recognized as positions that could not be shown in a "traditional" balance sheet, or if the firms using IFRS were required to draw up a reconciliation with more traditional accounting standards for purposes of determining the distributable profit.[22] However, the current debate seems to indicate that we may in the future see the introduction of a solvency test to replace or to complement accounting-based limits to distributions.[23] In fact, such an instrument may be more beneficial because its actual aim is to preserve liquidity, which is more important to creditors than an artificial capital figure.

Book-tax conformity has often been seen as another piece of the same puzzle. While the principle of authoritativeness has been an element of German tax law for over a hundred years,[24] Georg Döllerer is often credited with the idea that the government should be seen as another "dormant partner" of the corporation.[25] Since both distributions to shareholders and tax payments result in the withdrawal of funds from the firm and reduce liquidity available to make repayments to creditors, and both calculations determining these payments should be based on the firm's ability to pay, they should be made on the same basis. Döllerer warned against the danger that, without the binding power of financial accounting, tax law would entirely fall under the influence of political forces that would not take the firm's payment capa-

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20 ECJ, March 9, 1999, Case C-212/97, 1999 ECR I-1459 – *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*; November 5, 2002, Case C-208/00, 2002 ECR I-9919 – *Überseering BV v. Nordic Construction Co. Baumanagement GmbH*; September 30, 2003, Case C-167/01, 2003 ECR I-10155 – *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*

21 *See e.g.* BECHT/MAYER/WAGNER, Where Do Firms Incorporate? ECGI Law Working Paper No. 70/2006 (2007) (available at http://ssrn.com/abstract=906066).

22 *See e.g.* NOWOTNY, Muss die Übernahme internationaler Rechnungslegungsstandards an der Ausschüttungsbemessung scheitern?, in: HALLER (ed.), Internationale Rechnungslegungsstandards für Österreich, 143, 154-155 (2004); GELTER, Kapitalerhaltung und internationale Rechnungslegung, 33 Der Gesellschafter 177, 185-187 (2004); PELLENS/SELLHORN, *supra* note 19, at 377-379.

23 *E.g.* PELLENS/SELLHORN, *id.*, at 380-389.

24 *See e.g.* SCHÖN, The Odd Couple: A Common Future for Financial and Tax Accounting?, 58 Tax. L. Rev. 111, 115 (2005).

25 DÖLLERER, Maßgeblichkeit der Handelsbilanz in Gefahr?, 26 Betriebs-Berater 1333, 1334 (1971).

bility into account. Needless to say, conservative accounting plays into the hands of managers and owners of a firm, who are typically happy to reduce the tax base.

5. Risks and Problems Resulting from Book-Tax Conformity

5.1 Managerial Conduct

Bookkeeping, accounting and financial reporting are among the primary duties of a corporation's managers, or board of directors.[26] EU Directives, national laws and IAS[27] instruct them to pursue the goal of showing a "true and fair view" or giving a "fair presentation" of the firm's state of affairs. At least deliberate attempts to "cook the books" and to give a grossly distorted picture will typically result in civil and penal liability.[28]

The inclusion of taxation into the goals of accounting creates a managerial standard of conduct riddled with conflicts. The late Wolfgang Gassner expounded that, in order to pursue the interests of the company (however defined), one of the managerial board's duties was to minimize the tax burden.[29] In a legal system where a principle of authoritativeness is in place, the inevitable result is that the role of the "true and fair view" principle as the standard for accounting policies will be diluted. For example, when a decision on the depreciation period of an asset is to be made, the asset's usability in the company or its ability to generate cash should be the relevant criterion determining the accounting policy decision from an information perspective. However, in the presence of a principle of authoritativeness, managers will and must take into account whether the selected allocation of expenses over the coming financial years will be tax-minimizing.[30]

5.2 Transparency and Corporate Finance

The effects of the principle of authoritativeness on transparency largely depend on the firm's financial situation. In a profitable business, the mutually conflicting obligations to minimize taxes and to show a true and fair view arise. While managers generally want to show good results and a viable financial position in order to foster

[26] *See* Directive 2006/46/EC, 2006 O.J. (L 224) 1 (introducing, among other things, new Art. 10a into the Fourth Directive and Art. 36a into the Seventh Directive, which provide collective responsibility of members of administrative, management and supervisory boards for financial statements).

[27] Fourth Directive, Art. 4(3); IAS 1.13.

[28] Directive 2006/46/EC, *supra* note 26, introduces an explicit requirement for Member States to provide effective, proportionate and dissuasive penalties in a new Art. 60a of the Fourth and Art. 48 of the Seventh Directive. In the *Berlusconi* case (May 3, 2005, Case C-387/02, note 65), the ECJ had already affirmed that penalties for infringements of accounting provisions must be effective, proportionate and dissuasive, but concluded that the Directives cannot require Member States to set aside the principle of the retroactive application of the more lenient penalty.

[29] GASSNER, Steuergestaltung als Vorstandspflicht, in: BERNAT/BÖHLER/WEILINGER (eds.), Zum Recht der Wirtschaft, Festschrift für Heinz Krejci, 605, 610-613 (2001).

[30] *See e.g.* ROHATSCHEK, Die handelsrechtliche Generalnorm und das Maßgeblichkeitsprinzip im Spannungsfeld, 48 Journal für Betriebswirtschaft 242 (1998).

the development of the firm's stock price and to avoid being ousted (by a controlling shareholder or hostile bidder), they also prefer to retain funds within the company. All other things being equal, book-tax conformity can be expected to increase the tendency to create and retain hidden reserves. By contrast, in an unprofitable business (with only small prospects of offsetting current losses against future profits for tax purposes), the *de facto* reverse principle of authoritativeness does not create any tax incentives, since no taxes are paid. However, the incentive to convey a good impression of the firm in financial statements is particularly strong, as managers are subject to heightened pressure and risk to lose their jobs. In that situation, the incentive to realize and show hidden reserves reemerges where allowed by the applicable law. The possibilities to that effect may be stronger than without strong book-tax conformity where an incentive to create hidden reserves did not exist in the first place. Managers may even be induced to enter into transactions facilitating realization.

The likely financial effect is twofold, at least in profitable firms. First, managers may be forced to create purely discretionary, disclosed reserves that are needed to obtain certain tax benefits. Second, in the course of the firm's business activity, hidden reserves will develop. Both types result in a reduction of payable dividends and tax income, which increases the free cash flow available to managers. This may aggravate agency problems, as managers have a larger amount of funds at their disposal, as the typical desire not to distribute will be supported by the legal requirement to retain funds. In consequence, they may be able to use a larger amount of funds without being constrained by the owners' request for dividends.[31]

5.3 Dangers to Auditor's Independence

As discussed by other contributions to this conference, book-tax conformity is weaker in the U.S. than in countries such as Germany or Austria.[32] There is one curious effect that is hardly ever observed in specialist literature. Under the Sarbanes-Oxley Act and the SEC Auditor Independence Regulations,[33] auditors may in principle provide tax services to their audit clients as long as the audit committee approves of it.

In countries with stronger book-tax conformity such as Germany and Austria, tax services pose a greater danger to the auditor's independence than in the U.S. Through

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[31] WAGNER, Die umgekehrte Maßgeblichkeit der Handelsbilanz für die Steuerbilanz, 1990 Steuer und Wirtschaft 3, 9-10. This point is equivalent to the agency theory of free cash flow, according to which managers are more constrained by debt than by equity, as they have more free cash flow at their disposal in the second case. *See* generally JENSEN, Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers, 76 Am. Econ. Rev. 323-329 (1986). Agency cost of free cash flow should be even greater in the case of equity managers can avoid to distribute by reference to tax law.

[32] Also *see* LISCHER/MÄRKL, Conformity Between Financial Accounting and Tax Accounting in the United States and Germany, WPK-Mitteilungen, Special Edition June 1997, 91; SCHÖN, *supra* note 24, at 115-123.

[33] § 10A(h) of the Securities Exchange Act, as amended by § 201 of the Sarbanes-Oxley Act of 2002.

the *de facto* reverse principle of authoritativeness, any tax advice has an effect on the firm's financial statements, which is the main subject of the audit. German and Austrian law reflects this insofar as auditors of listed (and in the case of Austria, certain other large firms) are prohibited from giving tax advice if it goes beyond showing alternatives in structuring a transaction or using accounting policies *and* if its effects on the firm's financial position, assets, liabilities, income and expenses (as shown in the financial statements) are not immaterial.[34]

As a matter of legal policy, there are good reasons to ask whether giving tax advice should be entirely prohibited to the auditor as long as book-tax conformity remains intact. On the other hand, book-tax conformity creates an additional level of control for financial statements, as the prospect of a possible tax inspection always looms over the firm. The loss of the auditor's independence may thus be substituted by more intense public enforcement.

6. Potential Benefits of Book-Tax Conformity

There are various reasons to believe why strong book-tax conformity may be beneficial to corporate governance.

The Institute "Finanzen and Steuern" (Bonn) has recently pointed out that the replacement of traditional accounting standards by IFRS would result in an abolition of the principle of prudent accounting as understood in Germany.[35] However, in order to maintain the current level of tax receipts, the earlier taxation of profits that have traditionally been considered non-realized would have to be offset by the permission of an unlimited carrying forward of losses or other new measures of tax law. Alternatively a concept could be considered which makes sure that certain unrealized profits are eliminated by allocation to a mandatory reserve. The effect on corporate governance, of course, would be beneficial due to increased transparency.

Institutional investors are typically interested in transparent and timely information. From their perspective, the effects of taxation must be shown clearly. Transactions with no economic reason *per se* that are only justified by tax considerations should be discouraged, but in any case shown clearly in financial reporting. Generally, shareholders will want taxation not to influence management decisions and avoid a negative impact on transparency. Corporate dividend policy also matters to shareholders, who will generally prefer earlier distributions – or increased stock prices in earlier periods – to later ones.[36] Taxation also should not negatively affect the market for takeovers.

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[34] HGB § 319a(1)(2) [Germany]; UGB § 271a(1)(2) [Austria].

[35] INSTITUT „FINANZEN UND STEUERN" E.V., Bilanzierung nach IAS/IFRS und Besteuerung, 76 (2005).

[36] *Cf.* LA PORTA/LOPEZ-DE-SILANES/SHLEIFER/VISHNY, Agency Problems and Dividend Policies Around the World, 55 J. Fin. 1 (2000) (suggesting that shareholders' ability to force directors to pay dividends – particularly in countries with strong minority protection – prevents managers using a high proportion of gains for their own benefit). Different arguments are expounded by BREALEY/MYERS, Principles of Corporate Finance, 427 *et seq.* (7th ed. 2003).

Professional creditors (such as banks) will typically have the market power to request financial information from corporate lenders even without legal financial reporting requirements.[37] Hence, they would normally be able to obtain any financial information they need. Book-tax conformity should therefore be largely irrelevant as long as interest payments are deductible for tax purposes (which favors lending over equity finance) and distributions to shareholders and to the tax authorities do not render the firm insolvent or otherwise endanger the recovery of claims.

Management will want to avoid a negative impact on stock options, *e.g.* because of unfavorable tax treatment or types of disclosure that may convey an unfavorable picture of this form of executive compensation to shareholders.

Professor Schön has suggested that book-tax conformity could have a positive impact on transparency. Without it, management will typically be overoptimistic or inclined to show rather more than less in the capital market context. This bias could be balanced by conservative estimates that are driven by the desire (and obligation) to reduce the corporate tax load.[38]

However, management is required to distribute profits only when liquidity and the going concern are not endangered. Since dividends normally cannot be recovered from recipients, distributions putting these at risk may even result in managerial liability. This is an important corrective of over-optimism and may create a natural substitute for conservative accounting in the context of creditor protection. By contrast, it is not a substitute for conservative accounting in the context of the determination of taxable profits, as managers have no discretion whether to pay corporate tax or not. The underlying objective in both contexts, namely that shareholders and the state should participate only in the total profit over the lifetime of the enterprise, is hard to transpose into legal rules or principles, as distributions are not recoverable. Hence, while *ex post* liability of managers is needed for excessive distributions, *ex ante* mechanisms are needed to prevent excessive tax payments.

7. The Road Ahead: IFRS, Taxation and SMEs

IFRS are primarily of interest to large firms tapping the capital markets and are of particular significance for group accounts. Typically these firms will have sophisticated accounting systems, and the reduction of administrative costs by having a separate system of accounting for purposes of taxation will not be a significant burden. The reduction of administrative costs is important for small and medium-sized companies and is increasingly becoming a topic that is recognized as important at EU level. On the one hand, book-tax conformity and the possibility to prepare only a single set of accounts both for purposes of financial accounting and taxation provides obvious administrative relief. On the other hand, the introduction of IFRS could be a sound way to bring financial accounting and managerial accounting into

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[37] *E.g.* SCHÖN, Corporate Disclosure in a Competitive Environment, 6 J. Corp. L. Stud. 259, 291 (2006).

[38] SCHÖN, *supra* note 24, at 142-144; also *see* BALLWIESER, Ist das Maßgeblichkeitsprinzip überholt?, 1990 Betriebswirtschaftliche Forschung und Praxis 477, 493-494.

convergence. This might be beneficial for corporate governance, as it decreases information asymmetries between shareholders and management. Further it has to be considered that typically within small and medium sized companies, shareholders are involved in the daily business so that the importance of asymmetries might be rather small. In recent years, a debate has emerged about to what extent it would be feasible to equally apply IFRS to individual accounts of SMEs. The IFRS has recently issued an exposure draft on this topic.

However, on a more general note, there are good reasons to question whether mandatory disclosure of financial statements for all limited liability companies is a sound legal policy. Disclosure has met enormous resistance in several continental European countries, most of all in Germany, where less than 10% of GmbHs comply.[39] In a recent article, Wolfgang Schön has convincingly made the case that there is little to justify mandatory disclosure for non-public-interest firms.[40] It would suffice to require firms to submit accounts to shareholders only, which could be used for tax purposes at the same time. Banks and other creditors could require extended private disclosure if they believe that it is necessary for an appropriate estimate of the debtor's risk of failure. The exact extent could therefore be left to the market. However, this solution would require a decision at European level. The European Commissioner for Internal Market and Services has recently announced that the European Commission is focusing in the areas of accounting and auditing the possibilities of reducing costs for SMEs and therefore to submit the existing rules to a detailed scrutiny.[41] This could be the first step into this direction whereby always the whole picture (and this includes accounting for the purposes of taxation) has to be kept in mind.

[39] *See* MARX/DALLMANN, Jahresabschlusspublizität mittelständischer Unternehmen, 59 Betriebs-Berater 929 (2004) (reporting that less than 5% of entities required to disclose accounts fulfill this duty). In Austria, the compliance rate is at about 75%, although some notable for prefer paying fines to disclosure.

[40] SCHÖN, *supra* note 37, at 290-292.

[41] MCCREEVY, Speech at the European Parliament's Legal Affairs Committee, March 20, 2007, SPEECH/07/159.