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Discussant’s Response to  
Status Report on Auditing in the European Community

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The task of preparing a report on the status of auditing in a single country is a difficult one because of the many auditing aspects involved; preparing a status report on auditing in nine countries is even more difficult because of the differences among the countries. Taking this into account, Richard Kramer’s report gives a clear analysis of the current accounting and auditing situation.

I will not focus my discussion on the description of the current situation as such, but try to add some aspects that are relevant for an evaluation of that situation and for formulating expectations.

I will cover mainly three topics:

(a) The evaluation criteria used to analyze the status of auditing.
(b) The current status and future expectations about accounting.
(c) The current status and expectations concerning the future of auditing.

Evaluation Criteria

The problem of using appropriate criteria is probably the most difficult problem that one faces in evaluating the current status, since the outcome of the evaluation is very much dependent upon these criteria.

The author compares the situation of the EEC as a whole with that of the U.S., taking in most instances the American situation as a standard. It is undoubtedly interesting for U.S. accountants and auditors to compare their situation with the European situation. Unfortunately, however, this method of comparison obscures the fact that the EEC is so different from the U.S. that the two cannot realistically be compared.

First, the EEC consists of nine different states, each one having its own economic, political, and social system. To consider the EEC as a whole is at the present time only justified in the areas of agricultural and trade policy. The corporations in each of the member states are mainly operated under company laws, which are different in each state. There is not yet a European company operating under EEC rules.

A unified European capital market, in the sense that banking systems, stock exchanges, etc., are integrated, does not exist. Although there are, of course, in the EEC a number of multi-national corporations, the capital sources, ownership, and employees for most companies are concentrated in the countries where the companies have their main operations. So the financial statements and the attached auditing reports are mainly only of importance within each country.
Auditing work is done in each country according to national standards. The educational system in each country has the purpose of providing the required knowledge for an auditor to operate at a national level. Generally state laws require certain corporations to be audited, and at the same time set requirements for the auditor's qualifications. Foreign accountants are generally allowed to audit those corporations only if they have the same qualifications as national accountants.

The foregoing means that in each country auditing is mainly of national importance, and it has some specified meaning which is recognized within each country. Therefore, the status of auditing and accounting would be better judged by taking into account the national circumstances. In other words, the evaluation criterion could be: Do auditing and accounting, under the national political, economic, and social circumstances of a certain country, perform their functions well?

This statement of the problem does not take into account that there is a tendency toward economic, political, and social integration. But for the moment, this integration is not at all realized. Therefore, it is in my opinion that it is better to discuss this as a prospective issue, although this perspective clearly requires very important changes.

Accounting: The Current Situation and the Future

The author mentions five points, describing differences between accounting in the EEC and in the U.S. Some of these points are probably connected. Thus, if shareholdership is less important, it is to be expected that creditor protection receives more emphasis. Then too, it should be added that the interests of employees tend to become an increasingly important factor that should be taken into account.

Government involvement in setting rules for financial reporting is probably connected with the degree of freedom for national accounting professions to set accounting standards. With the author, I believe that too much government involvement can be a hindrance to prepare meaningful and fair financial statements, but on the other hand, if certain laws exist which prescribe certain strict rules, their appropriate evaluation criterion is whether or not those rules are good, taking into account the purposes and uses of financial statements in those countries. Especially since the investing public is less important in the EEC than in the U.S. and other groups are more important as users of the services of auditors and accountants, U.S. criteria are not valid in judging the adequacy of disclosure and valuation in the EEC.

From this viewpoint, undoubtedly, the situation in certain countries is not optimal (especially not in Italy). Additionally, tax laws requiring certain treatments of income determination in the financial statements can be obstacles to improvement of accounting standards, as Kramer has indicated.

The prospects for harmonization are, however, clearly laid down in the Fourth Directive of the European Community. Its second draft is influenced by the accounting profession, via the EEC Accountants' Study Group. This proposal is a basis for future development by means of its design. It is mainly directed toward disclosure, but it allows flexibility. However, it is still unclear to what extent there will be room for accounting standards, although it can be expected
that these will to some extent be proposed on an EEC level. The resulting system is not likely to be as extensive as the U.S. system of generally accepted accounting principles, and it will also be considerably more flexible.

As long as the economic and political integration is still in statu nascendi, it is in my opinion not a disadvantage that there remains some room for national financial reporting differences. The trend towards value accounting in the British Isles is very much comparable to the trend in the Netherlands, where we clearly see a tendency to show both historical cost and replacement cost-based profit calculations. This tendency is also present in Germany where the Accountants Institute recommended that financial statements should show the effect on profit of price changes of assets consumed in sales, as far as they were financed by stockholders' equity.

Auditing: Present and Future

The paper presents the following picture of the current situation:

(a) Auditing standards are different in the member states and are in some countries even absent.
(b) Standards of reporting are less developed.
(c) Auditing procedures are less stringently prescribed than they are in the U.S.

The auditing standards in each country are a reflection of the concept of auditing prevalent in that member state. The differences among the states can probably be expressed in the following generalizations. As far as the examination of the accounting system is concerned, there is a distinction between professions emphasizing the formal correctness of the books and those emphasizing auditing techniques that are more directed to problems of insuring that all the economic activities of a firm are properly reported. In the area of financial reporting, a distinction might be made between emphasis on legal requirements and emphasis on the adequacy of financial statements in providing information.

To appraise the situation properly, pronouncements on auditing standards need not necessarily be considered to be a good source, since at least in some countries they are only a reflection of generally accepted standards that are already operational. However, many firms apply their own, more detailed standards, and in some countries courts take jurisdiction on behalf of the profession to make certain that auditing practice is appropriate in the circumstances. So at least a partial explanation for the absence of stringent auditing standards is an individualistic attitude among auditors which emphasizes the choice of the appropriate techniques for each company. It might be expected that the above mentioned differences in approach towards auditing will make it very difficult to develop uniform auditing in the EEC.

An additional point is that auditing education is very different in many respects. In some countries universities are the main educational institutions, while in other countries, apprenticeship systems prevail. Harmonization of auditing education is an especially important requirement to develop a harmonized auditing practice in the future. In the current situation in each country there is a tendency to teach students the auditing approach that is prevalent in that
country. In the future, it will be very important to take a broader point of view, and that will require that standards are developed at an EEC level that define the concept of auditing.

Even when those standards are developed, the implementation in practice will take some time, since resistance to change will hinder auditors in many countries from changing their approach. In this area, there is certainly a big task for the EEC.

Finally, we should perhaps mention that many public accounting firms in the EEC have recently established relationships with firms in other EEC countries. This enables a mutual influence and can be a very important factor in harmonizing auditing standards.

In conclusion, it might be said that my opinion is different from Richard Kramer’s at the following points:

(a) In his evaluation, he takes largely the U.S. situation as a starting point and compares it with the EEC as a whole. I would prefer an approach that analyzes the situation in each country, taking into account the legal, economic, and social framework of the country.

(b) I have a more positive attitude towards the accounting harmonization proposals of the EEC.

(c) I think that auditing standards for the EEC as a whole in the future will be necessary, but in the current situation where (and if) the financial statements have only national significance, the lack of uniform standards is not as bad as Kramer suggests.

(d) The lack of explicit standards in some countries is partly due to an individualistic approach towards auditing, and does not mean that no standards exist, but rather that they (especially standards of fieldwork) are set for each individual case relative to the needs and relationships that have been discerned.

(e) It will be difficult to harmonize auditing in the future because of differences in auditing approaches. In this regard, as differences in auditing education among countries are overcome, change will be facilitated, but international cooperation on many levels will always be important.