

## ■ European traditions in accounting

# German Accounting Tradition

Rolf Uwe Fülbier and Joachim Gassen



### *The Beginning*

Although accounting thought in Germany can be traced back (at least) to the business practices of the Fugger family, the development of the academic German accounting tradition is closely connected to the development of business administration as a separate academic discipline in Germany. Erich Gutenberg (1897-1984), one of the most influential German business scholars in the 20th century, even claims that accounting research has helped German business administration to establish itself as a science. Also one of the oldest and most important associations for business administration in Germany, the Schmalenbach Society, bears the name of Eugen Schmalenbach (1873-1955), an accounting researcher and another major protagonist of German business economics in its early era.

Business administration arose as an academic discipline in the German speaking countries at the beginning of the 20th century. Birthplaces were business schools (*Handelshochschulen*) which were founded as a result of public demand for higher management education at university level (e.g., Leipzig, Aachen, St. Gallen and Vienna in 1898, Frankfurt and Cologne in 1901, Berlin in 1906). The first generation of academic scholars such as Johann Friedrich Schär (1846-

1924), Leon Gomberg (1866-1935), Joseph Hellauer (1871-1956), Eugen Schmalenbach (1873-1955), Friedrich Leitner (1874-1945), Heinrich Nicklisch (1876-1946), Wilhelm Rieger (1878-1971), Fritz Schmidt (1882-1950) and Walter Le Coutre (1885-1965) published seminal monographs on various fields, especially financial accounting and cost accounting. While mainly instructive and descriptive in nature, these works laid out the underpinnings of a normative measurement-oriented accounting theory. These thoughts, developed over time to more sophisticated theory constructs, spawned a long-lasting academic debate about the objective(s) and design of financial statements.

### *Development of German accounting theory*

Eugen Schmalenbach and Fritz Schmidt are probably the best known representatives of this early era. Schmalenbach developed theoretical foundations to cost and financial accounting. He established a system of cost accounting and cost theory which systematically links cost to production volume. He particularly emphasized the problem of activity level-independent fixed cost and developed the concept of imputed costs (*Kalkulatorische Kosten*). His notion of imputed interest on equity inspired modern value added theories. His concept of imputed costs and the resulting distinction between costs (*Kosten*) and expenses (*Aufwand*) caused a conceptual gap between cost and financial accounting. This distinction, which appears to some extent to be unique to the German environment, is also driven by the traditional focus of codified German financial accounting on tax calculation and profit distribution.

Schmalenbach's main attention, however, was on the measurement problems of financial accounting. Putting a strong emphasis on income measure-

ment, he developed an income statement-oriented form of accrual accounting, published and advanced in a series of papers and finally summarized in the first edition of his book *Grundlagen dynamischer Bilanzlehre* (1920, later *Dynamische Bilanz*). His publications stimulated a controversial debate about the objective of accounting in Germany during the 1920s and 1930s. Schmalenbach confronted his "dynamic" interpretation of financial statements with the "static" approach. According to the "static" perspective, the balance sheet as major financial statement reflects the net asset position, in particular the ability of the firm to meet its obligations in a timely manner. The calculation of profit or loss, derived from the change of net assets over the period, is being viewed as less important. Early representatives of the "static" theory were the lawyer Herman Veit Simon (1856-1914) with his seminal book about corporate financial statements in 1886, as well as Schär, Leitner and later, especially in dispute with Schmalenbach, Le Coutre, Nicklisch and Rieger. Both theory approaches, static and dynamic, influence German accounting regulation and practice until today. They also correspond to the current international debate about the asset-liability and the revenue-expense approaches.

Schmalenbach considered business administration to be an applied and prescriptive science. Addressing criticism such as Rieger's that pure science is value free he ironically proclaimed business administration as an art (*Kunstlehre*). The epistemological question about the role of value judgments was fiercely discussed at the beginning of the 20th century in the *Werturteilsstreit* and has been an open and controversial issue in German business economics and accounting research ever since.

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After World War I, the attempts to attend to the inflation problem in cost and financial accounting and the development of appropriate instruments for management and control strengthened the academic foundations of accounting and received a considerable international attention. The hyperinflation in Germany at the beginning of the 1920s challenged historical cost accounting and its ability to measure the value of net assets and income. Schmalenbach developed a concept of real capital maintenance based on price level adjustments. At the same time Fritz Schmidt advocated the maintenance of "real" net assets measured by current replacement prices. His current value approach had a wider scope than just solving inflationary problems: Schmidt proposed the universal application of his approach to detect the "real" return of investment. In his "organic" accounting theory (his book *Die organische Bilanz im Rahmen der Wirtschaft* was first published in 1921) the current replacement values of all single net assets add up to the reproduction value (*Reproduktionswert*) of the firm, which equals, under certain conditions, a specific form of the net present value of the invested capital. This valuation-oriented approach bears some similarities with the fair value notion of current accounting regimes. According to Schmidt the *Reproduktionswert* is a (supply) market-based net present value. Moreover, the preference for mark-to-market values, the subordinated role of reliability and the attempt to distinguish revaluation and speculation effects from the operating performance provide further analogies.

### **Development in Managerial Accounting and Valuation**

During Nazi dictatorship academic accounting thought quickly came to a near hold. Concepts of centralized state planning were developed by

those who accepted subordination, others suffered due to emigration, ban or other occupational obstructions. After World War II accounting research separated into a Western and Eastern stream. While the Soviet-style centralized planning system of the German Democratic Republic shaped accounting education and research in East Germany, accounting research lost its dominant position in West German business administration research. Erich Gutenberg (1897-1984) detached business administration from the accounting predominance. He tried to develop a comprehensive model of firm processes by bridging the gap between business administration and neoclassical microeconomic theory. In contrast to the fragmented, often pragmatic and qualitative works before, he introduced a consistent, mathematical-quantitative approach. Moreover, in contrast to Schmalenbach and the practical normative tradition of the discipline so far, Gutenberg proposed a positive descriptive approach to business economics. The old methodological and epistemological dispute (*Methodenstreit*) blazed up again, this time in particular between Gutenberg and Konrad Mellerowicz (1891-1984).

The thoughts of early academic generations around Schmalenbach and Gutenberg still affect cost and management accounting theory even today. However, considerable progress on various fields occurred in the second half of the 20th century. The 1960s were characterized by a lively discussion concerning the methods of direct and marginal costing, particularly the different systems of standard marginal costing which were developed, partly based on Gutenberg's concepts, into applicable procedures. Contributing pioneers include especially Gutenberg's former research assistant Wolfgang Kilger (1927-1986) and Hans-Georg Plaut (1918-1992) with their publications about marginal cost accounting (*Grenzplankostenrechnung*). Worth mentioning is also Paul Riebel (1918-2001) and his insights into relative direct costing (*Relative Einzel-*

*kostenrechnung*). The U.S. based concept of activity based costing was modified in the 1980s especially by Péter Horváth (born 1937) to a process-based approach (*Prozesskostenrechnung*) although basic elements were already described by Schmalenbach and, later, Kilger. However, at the same time, a noticeable gap between academic theory and practice developed. The full cost methods, which had been developed, standardized and applied in Germany during the 1930s, dominated corporate practice for a long time.

A more current topic in German management accounting research focuses on convergence and integration of accounting systems. On the one hand there have been endeavors to integrate accounting information into capital budgeting and strategic business planning activities. On the other hand, the traditional German separation between management and financial accounting has eroded since the early 1990s. Also, there has been an increasing demand for a modification of traditional cost accounting techniques into management-oriented instruments. Against this background, the rise of "controlling" started in Germany in the 1970s when Horváth accepted a newly created chair of controlling at Darmstadt Technical University (later Stuttgart). Only some decades later, controlling is not only widely accepted as part of corporate organization but also established academic discipline at Universities in the German language area. In contrast to the terminological roots in the English language and the Anglo-American controller tradition, the notion of controlling specifies a unique German language area approach to management accounting and beyond. However, there is still no common understanding. Major protagonists of controlling thought such as Horváth, Hans-Ulrich Küpper (born 1945) and Jürgen Weber (born 1953) are linked with different concepts.

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Closely connected to measurement theories of financial accounting, an accounting-based literature on firm valuation developed in the 1950s and 1960s. Compared to the U.S. valuation literature, the German literature is less capital-market based and focuses more on acquirer-specific valuation approaches, also incorporating tax effects in substantial detail. This different focus seems understandable, given the market share of German private firms. The development of this literature is especially connected to the University of Cologne (*Kölner Schule*) and researchers such as Hans Münstermann (1899-1986), Walther Busse von Colbe (born 1928), Günter Sieben (born 1933) and Manfred J. Matschke (born 1943). This specialized strand of literature is still active today and continues to have a focus on specific German aspects, for example the effect of different legal forms and tax considerations (see especially the relevant publications of Adolf Moxter (born 1929), Jochen Drukarczyk (born 1938), Lutz Kruschwitz (born 1943) and Wolfgang Ballwieser (born 1948)).

### **Link Between Accounting and Law**

Financial Accounting thought in Germany after the World War II was closely related to legalistic thought. Ulrich Leffson (1911-1989) and, later, Jörg Baetge (born 1937) advanced the understanding of the basic principles of financial accounting (GoB). Moreover, legal and business scholars such as Georg Döllerer (1921-1993), Heinrich Beisse (born 1927) and especially Adolf Moxter (born 1929) turned away from the classical prewar accounting theories and the pure business economic tradition of accounting. They developed the legal doctrine of accounting (*Bilanz im Rechtssinne*). Due to the close link between financial and tax accounting in Germany, supreme tax court (*Bundesfinanzhof, BFH*) decisions were analysed in order to es-

tablish a positive and jurisprudential grounded accounting theory. Academic researchers use stated accounting objectives and their strong institutional expertise to answer open accounting questions. Doing so, accounting academics have influenced and continue to influence legal thought as documented by significant contributions to influential legal commentaries.

It is an open question why the legalistic, often legalistic-deductive research tradition has been dominant in Germany compared to, e.g., empirical research approaches. Several explanations seem possible: The code law tradition in Continental Europe and the principles-based regulation as well as the fact that legal consequences such as taxation, profit distribution and insolvency have been directly linked to financial accounting. Moreover, data availability was limited, also because of the relative small numbers of publicly-listed firms in Germany. Especially the latter may justify the rise of empirical capital market oriented research when international accounting has been introduced in Germany in the 1990s. The characteristics of the German university system, for example the non-existing or, at the most, weak department structures, the typical career path of German doctoral accounting students, many of them choose careers outside academia, and the (resulting) lack of standardized doctoral education might be additional issues. All these factors may motivate to realize synergies between research and rules-oriented teaching and may explain a certain distance to econometric methods, to higher specialization and to the "publish or perish" game.

### **Accounting and Economics**

A major strand of current German accounting literature uses the microeconomic toolbox to analyze research questions in the area of accounting. Although German accounting theory was right from the beginning embedded into economic thought (see esp.

Fritz Schmidt), this development was also inspired by the US driven idea of "economic analysis of law" and the rise of neoinstitutional microeconomics since the 1970s and 1980s. The analytical formalization is especially connected to the works of Ralf Ewert (born 1957) and Alfred Wagenhofer (born 1959) and their respective research (see their two major books about management and financial accounting as distinct examples). Currently, researchers from German speaking countries play a significant role in the international domain of analytical accounting research.

### **Internationalization and rise of empirical research**

Driven by the internationalization of accounting practice at the beginning of the 1990s, the first academic chairs of international accounting were founded at the universities in Frankfurt (Dieter Ordelheide, 1939-2000) and in Münster (Bernhard Pellens, born 1955, later Bochum). This first generation of scholars introduced US-GAAP and IAS/IFRS to both, German academics and practitioners. The PhD thesis of Axel Haller (born 1961) about US-GAAP in 1988 is a well-known example. Driven by the traditional deductive orientation of German research the frameworks and basic principles were also intensively analyzed and, quite frequently, inconsistencies between rules and principles were identified. Even the traditional German concept of commentaries – huge and detailed interpretations which are necessary in a principles-based system – has been applied in the context of IFRS.

In the beginning, the U.S. driven positive-empirical turn in research methodology in the 1960s and 1970s had only a modest impact on the research agenda in Germany. However, the importance of positive empirical research has increased substantially over time.

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Early empirical studies addressed accounting-based prediction models, the value relevance of alternative financial reporting regimes and, of course, the effects of IFRS adoption. The long-time dominance of non-empirical research methods also applies to management accounting. Normative, conceptual and analytical methods have dominated the relevant publications whereas empirical research account for only a minor portion – however with upward trend. Most of the empirical research comprise here case and field studies. Large-sample and archival studies have been scarcely conducted.

### Current Situation

The process of internationalization has continued. While internationalization in German codification and accounting practice was and still is restricted to the group accounts, single financial statements remained unaffected due to their material legal consequences. Therefore, the German financial accounting world has separated into two subsets: Capital market oriented accounting at group level, especially for publicly traded companies based on IFRS, and the more contracting, i.e. tax, dividend distribution and debt covenants oriented HGB accounting on the legal entity level. This distinction also affects the research community which increasingly disaggregates due to the necessary specialization in both areas.

In recent years, the German university system is undergoing substantial changes with respect to funding and incentivitation. Research output is being evaluated on an international level and countable success is the key to prestigious positions, funds and other resources. Therefore, especially younger accounting scholars are forced into the “publish or perish“ game. Accepting this change of rules, they focus on research questions and methodologies

which might yield publications in renowned international journals. Journal rankings, like the one published by the German association of business professors (VHB) or by a German leading business newspaper (*Handelsblatt*), consistently rank even mid-tier international journals higher than top German research journals. As a result, German accounting scholars and their research have become more visible internationally (see for example the increasing German attendance at EAA annual congresses in the last years). In addition, doctoral education in Germany is becoming more structured and methodologically oriented.

Although the focused interest on publishing results in internationally renowned journals has led to an increase of “international mainstream” research, there is an observable interest in other, internationally approved research fields and methods aside the mainstream. As an example, German language scholars get more visible in areas like behavioural accounting, critical and epistemological approaches and accounting history. The hope is that the specific German accounting research tradition with its prescriptive roots will survive on an internationally competitive level, contributing to our understanding of complex accounting phenomena and keeping in mind that accounting research is an applied science and not an end in itself.

Reading list (in-depth overviews about the German accounting tradition):

Ballwieser, W. (2010) Germany, in Previts, G. J. et al. (eds.) *A Global History of Accounting, Financial Reporting and Public Policy: Europe*, Bingley: Emerald.

Busse von Colbe, W. and Fülbier, R. U. (2012) Accounting and the business economic tradition in Germany, in Biondi, Y. et al. (eds.): *Accounting and Business Economics: Insights from National Traditions*, London: Routledge (forthcoming).

Küpper, H.-U. and Mattessich, R. (2005) Twentieth century accounting research in the German language area, *Accounting, Business & Financial History*, 15: 345-410.

Schneider, D. (2001) *Betriebswirtschaftslehre, Vol. 4: Geschichte und Methoden der Wirtschaftswissenschaft*, München/Wien: Oldenbourg.

*Rolf Uwe Fülbier is Professor at the University of Bayreuth*

*Joachim Gassen is Professor at the Humboldt University, Berlin*