

Legal Status of Accounting Standards – comparative studies (4)

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Chapter 6 The Netherlands

1 Before the Annual Accounts Act 1970

Article 6 of the Commercial Code 1837 (Wetboek van Koophandel, Wet van 10 mei 1837, Stb. 21) required every merchant to keep a journal in order to record his receivables and payables, the affairs of his trade, the drawing, acceptance and endorsement of bills of exchange and other notes. In addition, the second sentence of the same Article provided that a merchant should keep such accounts as are customary in the trade (in de koophandel gebruikelijk) even in cases where the keeping of which was not required by the law.

On the other hand, in 1886, the Penal Code (Wetboek van Strafrecht) was enacted and Article 336 of which stipulated that a merchant, the management and the supervisory organ of a company with limited liability or a cooperative organization who deliberately publish an untrue balance sheet shall be subject to imprisonment up to one year. There had been, however, no legally recognized criteria by which the verity of a balance sheet be judged and no statutory requirement for companies to publish their balance sheet before 1928¹.

In fact, several efforts were attempted to revise the provisions concerning company accounting as part of the reform of law on companies with limited liability. For example, in 1871, the Minister of Justice *Jolles* delivered a Bill to the Parliament and requiring publication of financial statements was considered at a committee of the Parliament². In addition, *Kist* Committee published in 1890 a report and a draft law on companies with

1 Since 1909, the Stock Exchange Association (Vereeniging voor den Effectenhandel) had requested listed companies to publish a balance sheet and an income statement.

2 *Bijlagen Handelingen*, Tweede Kamer, Zitting 1871-1872, blz. 2214-2233.

limited liability (*Ontwerp van een wetsvoorstel betreffende de vennootschap onder eene firma, de commanditaire vennootschap, NV, de onderlinge waarborgmaatschappij*)³, which proposed to require a company to publish a balance sheet and an income statement on official gazette and make them ready for public inspection at the principal office of the company (Article 70). Both of them, however, never led to a parliamentary enactment while the 1928 amendments (Wet van 2 juli 1928, Stb. 216) and the 1929 amendments (Stb. 363) introduced the requirements to disclose a balance sheet at a commercial registry⁴. Above all, the 1929 Act did stipulate neither the items to be shown on the liability and equity side of a balance sheet nor the accounting treatments⁵ while it provided the items to be shown on the asset side (Article 42, paragraph 3). Meanwhile, in the course of the 1928 amendments, the Minister of Justice *Donner* noted that it is possible for the economic and social climate (*maatschappelijk verkeer*) to give clear suggestion about what is a balance sheet that has been prepared properly⁶.

2 Recognition of the need for setting accounting standards

(1) The move in the NivRA

In the move to enacting the Annual Accounts Act, the Dutch Institute of Registered Accountants (NivRA) had become aware of the need to setting accounting standards. In April 1967, *Tempelaar*, the President of the NivRA, noted that one of the important challenges to be more important as the result of the expecting legal regulation on financial statements is to shape the requirements that the financial reporting must meet, concerning both their contents and presentations. He argued that the auditing profession would have to play a leading role in cooperation with business and the universities (*Tempelaar* [1967] p.10–11). Moreover, *Kraayenhof* remarked on the podium that the development of

3 reproduced in: *Ontwerpen van Wet met Memoriën van Toelichting, den Koning aangeboden door de Staatscommissie tot herziening van het Wetboek van Koophandel*, Belinfante, 1891.

4 On this occasion, Article 336 of the Penal Code was amended to provide criminal sanctions to an untrue income statement.

5 Notes on basis of valuation of assets were, however, required. The Stock Exchange Association provided in 1958 that annual accounts should give a faithful picture (*getrouw beeld*) but it did not stipulate concrete regulation.

6 *Bijlagen Handelingen*, Tweede Kamer, Zitting 1826–1827, blz. 1832.

accounting standards was laid before the profession and should be given high priority and it is a very important and urgent task for directors of companies to choose from the alternative methods that fall within the norms implied by the law. He pointed out the need of a committee to be appointed by the NivRA, which would make an inventory of the valuation principles and other accounting guidelines. He argued that the criterion of acceptability would be applied in consultation between a committee of the Council of Netherlands Employers Federations and the committee of the NivRA (Kraayenhof [1967] p.17–18)⁷.

(2) Expression of hope by the Minister of Justice and response by the NivRA

Later in May 1968, when the Annual Accounts Bill was introduced to the Parliament, the Minister of Justice *Polak* remarked in the Explanatory Memorandum in regard with Article 5 of the Bill on valuation and income determination as follows: I expect that organized business in cooperation with the auditors' organization will consider it as their task to make an inventory of these principles applied in the economic and social climate, as implied in Article 5, and to judge them on the basis of what, in their opinion, can be considered as acceptable in the economic and social climate and meeting the requirements in Articles 2 and 3. The deliverables on acceptable principles will meet a clear need on the part of managements of enterprises, and can serve as a point of reference as well for the

7 Behind this background, the Companies and Business Court (*ondernemingskamer*) was created at the Amsterdam Court of Appeal. The Companies and Business Court adopts expert participation system, in which the court consists of 3 ordinary judges and 2 expert judges. Accordingly it was recognized that expert judges needed materials to persuade ordinary judges who are experts in law (Kraayenhof [1967] p.18). The Companies and Business Court has the exclusive jurisdiction in cases where the issue is whether financial statements are against the law (originally Annual Accounts Act, Article 32 Later, Civil Procedure Code, Article 1000 [until 31 December 2006], currently, Civil Code, Article 2:447). While the the case will be heard *in camera*, judgment should be declared publicly (originally Annual Accounts Act, Article 33, paragraph 4. Later, Civil Procedure Code, Article 1001, paragraph 4 [until 31 December 2006], currently, Civil Code, Article 2:450, paragraph 1). *See also* note 17. With regard to the core provisions governing annual accounts, the Social and Economic Council opined that the considerations given by the Companies and Business Court “could embody the procedures for annual accounts and develop case law that plays a leading role” (SER-advies, 1969, nr.4, 20 mei 1969, p.5). In line with this, the Minister of Justice expressed a view that “legal requirements with an inevitably general nature would be embodied for individual cases” as a result of the procedures by the Companies and Business Court (*Memorie van Antwoord*, Tweede Kamer, 1968–1969, 9595, 9596, nr.6, p.4). For details of the Companies and Business Court, *see e.g.* Klaassen [1980] and Jitta *et al.* [2004].

Companies and Business Court”⁸.

In response to this suggestion, the NivRA set up the Advisory Commission relating to Annual Reporting (Commissie van Advies inzake Jaarverslaggeving, CAJ) in 1969. The mandates to this commission were not only to undertake research on opinions and insights into the matters relating to financial reporting by enterprises in the Netherlands and abroad but also to study financial reporting insofar as it results from current and expected legal regulation in order to contribute, as a professional body, to shaping the requirements financial reporting must meet (NivRA [1968] p.13). The CAJ never did, however, give advice the members of the NivRA, let alone to companies, on accounting principles (Zeff *et al.* [1992] p. 190).

(3) Tripartite Study Group

In August 1971, the Tripartite Study Group (Tripartiete overleg), consisted of representatives of employees (Consultative Council of Trade Union Federations [Overlegorgaan Vakcentrales])⁹, employers (Council of Netherlands Employers Federations [Raad van Nederlandse Werkgeversverbonden]) and auditors (NivRA), was organized¹⁰.

8 *Memorie van Toelichting*, Tweede Kamer, 1967–1968, 9595, nr. 3, p. 14. In addition, *Polak* argued as follows: “As already mentioned in the explanation to Article 3, the Bill does not prescribe specific standards for valuation. In the first place, the scientific study of managerial economics is still too fluid to capture a certain method in the law; valuation based on the replacement cost will be justifiable equally with that on the basis of historical cost. In addition, some accounting policies lend themselves better for some industrial sectors than for others. Finally, it is important that a future development will not be impeded. It is, therefore, endorsed, as the Corporate Law Commission, not to choose a particular method, but to let the business to have some discretion. That freedom is not unlimited: the valuation must meet standards considered acceptable in the society. The criterion of “sound business practice (goed koopmansgebruik)” is not included in the Bill because it has been given too broad meaning in practice.” (*Memorie van Toelichting*, Tweede Kamer, 1967–1968, 9595, nr. 3, p. 13–14).

9 It is widely recognized that representatives of employees participated in this Group because the Annual Accounts Act had not been enacted in response to serious concern about financial reporting practices but introduced as a part of the company law reform to achieve the employees’ participation in management (Burgert[1981] p.53) and because the Works Councils Act of 1971 placed workers in a class of “interested parties” in regard with financial statements (Groeneveld [1972] p.365).

10 For the details of the development, see Zeff *et al.* [1992] pp.192–201. Meanwhile, some criticized that there might be no good reasons why the Group consisted of three parties, employers, employees and auditors while the providers of the capital (shareholders) and politicians were not included in the Group (Bouma [1972] p.103). *Groeneveld* explained that shareholders had not been invited since they had not yet been organized (Groeneveld [1972] p. 365. Klaassen [1980] p.331 was of a similar view).

They agreed that “Observations (Beschouwingen)” would be the title of the publications of the Tripartite Study Group since the Chairman thought that “rules (Regelen)” would be too strict (Zeff *et al.* [1992] p.201).

In 15 December 1971, the “Preliminary Draft of Observations as a consequence of the Act on Annual Accounts of Enterprises (*Voorontwerp van Beschouwingen naar aanleiding van de Wet op de Jaarrekening van Ondernemingen*)”, which covered participations (deelnemingen) and other long-term shareholdings, inventories, long- and short-term liabilities and liabilities not to be shown in the balance sheet, was issued. In its “Introduction”, the mission of the Tripartite Study Group, the outline of the future works and the premises of the Act were stated, followed by the statement on equity, income, changes in owners’ equity, change in values over time, methods for income determination and what are considered as assets and liabilities. It clearly declared that the statement of the Tripartite Study Group should not be seen as prescription (voorschriften) since it was not the mandate to the Tripartite Study Group to set rules. The 1974 draft “Observations”(Tripartiete Overleg [1974])¹¹ further took the position that the Tripartite Study Group “provides guidance to practice by means of these Observations so that financial statements will correspond to the objective given in the Act” (Ia, paragraph 5) with reservations that “not all principles that are currently in use have been examined and it might not be concluded that those are not examined are unacceptable” (Ia, paragraph 6). It noted, however, that the evaluation made by the Tripartite Study Group on what occurs in the economic and social climate “might occasionally lead to the conclusion that something can, under certain circumstances or in the current order of things, not or no longer be considered as acceptable” and that it was possible that one alternative must be designated as preferable even in cases where none of the alternatives could be considered as unacceptable (Ia, paragraph 14).

Some were of the opinion that the authority of the organizations behind the Tripartite Study Group should have merited a stronger term, such as “recommendations (aanbevelingen)” to characterize its view or “guideline (richtlijnen)” (Krens en Bulte [1972a]

11 From 18 February 1973 to September 1979, exposure drafts, including the preliminary exposure draft of 15 December 1971, were divided and published seven times for comments. Taking the submitted comments into account, revised final Draft Observations were published between May 1974 and 1979 but did not become final “Observations”.

p. 198)¹².

(4) NivRA's request to the members on compliance to the Guideline

The foreword of the Draft Annual Accounts Guideline, which was published in June 1980 (Tripartiete Overleg [1980]), said that the Group expected that the organization of auditors (NivRA) would make an effort to ensure that those in charge of audits take compliance with the Guideline into consideration and that they make mention of a departure from the Guideline in their audit report (p. IX)¹³.

On the other hand, the Council on Professional Issues (College voor Beroepsvraagstukken) of the NivRA was of the view that the NivRA could bind its members effectively to report on departure from the Guideline only by issuing an ordinance (verordening) under Article 19 of the Registered Accountants Act while the NivRA's authority on such matters was still an open question (Zeff *et al.* [1992] p.311). In the course of review, the Council consulted the advice that had been received from legal counsel in 1978 in regard with the 1976 NivRA management board (bestuur)'s statement calling upon NivRA members to disclose departures from IASC standards that had been declared by the board to be "generally accepted" in the Netherlands (NivRA [1976] p.616-617). The legal counsel had given advice that an attempt to bind NivRA members by the International Accounting Standards could be seen by the Minister of Justice and the courts as an attempt

12 Among the comments to the exposure draft, some argued that the work of the Tripartite Study Group must result in a sort of "code" for the principles of valuation and income determination, which are expounded in such a way that a violation of the principles would clearly be recognized as censurable or even impermissible (Moret & Limberg, *as quoted in* Zeff *et al.* [1992] p.213).

13 *Ballard* noted that the Guideline pronounced by the Tripartite Study Group played an important role (*Ballard* [1974] p.23) and a violation of the Guideline might be subject to the disciplinary proceedings of the NivRA though the Guideline had no formal binding force (p. 24). Moreover, *Klaassen* pointed that the pronouncements of the Tripartite Study Group were intended to have an impact upon practice, but they were neither mandatory for companies to follow these pronouncements, nor were they obligatory for auditors to qualify their reports if the pronouncements were not followed. Accordingly, he argued that the pronouncements of the Tripartite Study Group could best be described as authoritative opinions of an influential private group (*Klaassen* [1980] p.330). Furthermore, *Rutteman* points out that the Guideline issued by the Tripartite Study Group was deemed as highly persuasive at least but was not mandatory (*Rutteman*[1985] p. 336). On the other hand, a lot of critical views had also been expressed to the "Observations" of the Tripartite Study Group (*e.g.* *Krens en Bulte*[1972a][1972b], *Bouma*[1972], *Groeneveld* [1972]. *See also* *Burgert, van Hoepen en Joosten* [1968] blz. I. 3.3.7.1).

to bind audited companies as well, which would extend beyond the NIVRA's authority and that the legal regulation on the contents of financial statements was directed to companies. He advised that such an undertaking should be proceeded cautiously and it would need to do by issuing "urgent advice from the board" if the NIVRA board should intend to encourage auditors to seek company compliance with the International Accounting Standards. On the other hand, a Section of the management board decided that it had a different view from the board's 1976 Statement on auditors' obligation concerning the International Accounting Standards and advised the full board to refine the 1976 Statement by stating that it would not consider an International Accounting Standard as "generally accepted" until it was included in a statute or was confirmed in a court decision and not to advise NIVRA members to make note of departures from the International Accounting Standards and the Guideline of the Tripartite Study Group in their audit reports. The board's executive committee was, however, of the opinion that the management board has an authority to decide that NIVRA members should draw attention to departures from the Guideline in an audit report because non-compliance to the Guideline might lead to a "non-faithful image" (Zeff *et al.* [1992] p.311). The Council on Professional Issues then set up an advisory working group, which found that the 1976 NIVRA Statement concerning the International Accounting Standards went too far because the status of the Standards as "generally accepted" could be achieved by inclusion in a statute or recognition by court decisions.

The working group came to the conclusion as follows: the Tripartite Study Group could not issue legal binding rules (rechtsregelen)¹⁴; the NIVRA could never go beyond a "strong recommendation" that its member should strive for compliance with the Guideline; therefore, the Tripartite Study Group had gone too far in stating the expectation in the Foreword on the role to be played by the NIVRA and auditors; the NIVRA management board could issue a "statement of opinion (meningsuiting)" that gives its view on the degree to which the Guidelines constituted the "demands placed on the financial statements"; a "statement of opinion" should be issued only for a specific Guideline, not as a *carte blanche* to all Guidelines (Zeff *et al.* [1992] p. 312).

As the Council on Professional Issues could not, however, arrive at a conclusion

14 Beckman argued that the Tripartite Study Group was not a rule-making body and had no formal status (Beckman [1980] p. 60).

whether it should issue a statement of opinion, after the discussion at the management board, the NivRA issued a discussion draft (ontwerp ter discussie) No.15 “The importance of the Guideline of the Tripartite Study Group (now the Annual Reporting Council) for the auditors’ report” in January 1982. This document argued as follows: affirmative pronouncements (stellige uitspraken) of the Tripartite Study Group have, for members of the NivRA, the importance similar to that of the statements of opinion of the management board and the Council on Professional Issues, both of which are designed to give guidance to members on the matter in which the profession is exercised and have such a degree of authority that departures must be justified by sound reasons; a departure from an affirmative pronouncement of the Tripartite Study Group will require the auditor to give sincere consideration whether the financial statements nonetheless meet the demands placed on them, and, if not, in what way this must be disclosed in the auditor’s report; a statement in the auditor’s report can be omitted, however, in cases where the auditor is of the opinion that the departure is justifiable by sound reasons (NivRA [1982] p.7).

Later, in January 1984, the Annual Reporting Council(RJ) issued the Guideline for Annual Reporting (Richtlijnen voor de Jaarverslaggeving). The Foreword (voorwoord) to the Guideline made the following statement: the RJ seeks to place in proper perspective the significance of the Guideline for the annual reporting practice, by making a distinction in the Guideline between affirmative pronouncements (in bold face) and recommendations, which implies that additional weight is to be given to the affirmative pronouncements in bold face; the RJ does not, however, claim that the affirmative pronouncements in the Guideline have binding force equivalent to the provisions in statutes; it is the courts that will ultimately decide, in each case brought in front of them, which principles are considered to be acceptable in the economic and social climate for the financial statements in question, which implies that the reporting entity has its own responsibility for its financial statements; the RJ thinks that the Guideline, especially the affirmative pronouncements therein, will contribute generally, by their intrinsic value, to the insight into financial position and income required by law, which implies that it can be expected that there will be departure from an affirmative pronouncement only when there finds sound reasons for the departure (Raad

voor Jaarverslaggeving [1984])¹⁵.

Since the NivRA could not reach a conclusion that a definitive statement of opinion can be issued that would obtain sufficient support from the members and since the Annual Reporting Council seemed to expect that the NivRA would promote “that the Guidelines and the affirmative pronouncements therein are taken into consideration in the audits of financial statements” as far as possible, judging from the Foreword to the Guidelines, and the Council no longer included the element relating to the implication of affirmative pronouncements for the auditor’s report in its expectation (NivRA[1984] p.743), the Discussion Draft No.15 was withdrawn.

Judging from this history, it is regarded that the NivRA has never required the members to follow the Guidelines (cf. Klaassen [1980] p. 330), but encouraged the use of the Guidelines in a more informal way (Bollen and Lin-van Nuffel [1997] p.64. *See also* Rutteman [1985] p.336). *Schoonderbeek* noted at the same time that auditors recommended to comply with the Guidelines (*Schoonderbeek*[1992]p.77). In fact, the NivRA expressed its opinion that the Observations of the Tripartite Study Group should become stricter and more binding on the interested parties (NivRA [1978] p.151).

In addition, *Klaassen* pointed out that the “lack of status of the accounting standards, however, need not imply that auditors should not, or do not, urge the management to comply with the pronouncements” of the Tripartite Study Group (*Klaassen* [1980] pp. 338–339). He argued that there might be good reasons for voluntary compliance to the pronouncements of the Tripartite Study Group. This was partly because the accounting standards could play an important role, by giving companies that apply these standards as a defense in court¹⁶. Moreover, since the court’s arguments in support of its rulings as they might apply to future cases are less strict than the respective accounting standards, companies complying with these pronouncements probably run only a very low risk of being forced in a court case to correct their financial statements¹⁷. In addition, he noted as follows: “If the number of court

15 That is still the case (Raad voor de Jaarverslaggeving [2007]).

16 *Klaassen* pointed out, however, that the pronouncements of the Tripartite Study Group had only rarely been used by defendant companies so far (that is, until 1980) because such a defense could be helpful only if the point at issue were not very specific, since the standards are written at a general level (*Klaassen* [1980]p. 339).

17 The public prosecutors have been passive in the sense that they had seldom taken the initiative to sue companies for non-compliance with the Annual Accounts Act. It has been left to the interested

cases is low, many practices will not be judged by the court. But even if there were many court cases, these could not be considered a good substitute for setting accounting standards by some institutional body, since the court only decides on cases, and does not give a comprehensive and general treatment of accounting and reporting problems”¹⁸.

parties to complain. Articles 31 through 35 of the Act were the provisions concerning the Companies and Business Court (*See supra* note 7) and provided that any interested party (it was expected that the range of the interested party would be construed widely [*Handelingen*, Eerste Kamer, 1969–1970, p. 1093–1094. *See also* van der Zanden [2004a] p.164]. According to court decisions, shareholders [NJ 1979, 373 *Douwe Egberts*; NJ 1978, 441 *Sekisui*; NJ 1979, 566 *Koninklijke Scholten Honig*] and trade unions [NJ 1978, 442 *Homburg*; NJ 1981, 258 *Batco*] have always been regarded as having interests and, employees have been treated as interested parties as long as there is no proof to the contrary [NJ 1979, 572 *Sijthoff*; NJ 1987, 973 *De Schelde*] while other persons have standing to sue only in cases where they are successful in proving that they have direct economic interests (the court once recognized the SOBI[*See infra* note 42], which insisted that it had an intention to buy the shares, had standing. NJ 1980, 122 *Vulcaansoord*] [NJ 1987, 307 *GKN*; NV 1985, 32 *Nivo/Navo*; NJ 1989, 225 *Naba/Hurks*; NJ 1997, 113 *Coberco*] may (Article 31, paragraph 1. Later, Article 999, paragraph 1 of the Civil Procedures Code. Currently, Article 448, paragraph 1, no.1 of Book 2 of the Civil Code) bring matters before court within two months following the date on which the accounts have been published or adopted, arguing the company violated the Annual Accounts Act (Article 33, paragraph 1. Later, Article 1001, paragraph 1 of the Civil Procedures Code [until 31 December 2006], currently, Civil Code, Article 2:449, paragraph 1). Moreover, the Advocate General of the Amsterdam Court of Appeal may submit the request to the court in the public interest (Article 31, paragraph 2. Later, Article 999, paragraph 2 of the Procedures Code [until 31 December 2006], and currently, Civil Code, Article 2:448, paragraph 1, no.2). The procedures are not intended for the compensation of damages but aimed at the improvement of financial reporting, ordering to restate financial statements and/or to provide supplementary information, and directing how accounting and reporting changes should be made in the future (Article 34. Later, Article 1002 of the Civil Procedures Code [until 31 December 2006], and currently, Civil Code, Article 2:451). While the losing party can appeal to the Supreme Court against a final judgment of the Companies and Business Court (After the amendments to the Civil Procedures Code made by the Law of 6 December 2001, an interlocutory decision became unappealable), the Supreme Court can make decisions only with respect to application of the law. In cases where the verdicts of the Court are not complied with, the officers of the defendant enterprise will be punished. Though the auditor is not a party in the case, the Companies and Business Court has to give the auditor an opportunity to be heard (Article 33, paragraph 5. Later, Article 1001, paragraph 5 of the Civil Procedures Code [until 31 December 2006], and currently, Civil Code, Article 2:450, paragraph 5).

¹⁸ It seems that some influence was exerted by auditors recommending that the pronouncements of the Tripartite Study Group be followed. NivRA [1979] pp.13–15.

3 Trend of court decisions before the 1985 decision of the Board of Appeal¹⁹ and the view taken by the Minister of Justice

Initially, judges who had experience of judges at the Tax Division of the Court of Amsterdam were appointed as judges of the Companies and Business Court. They were accustomed to decide in the light of “sound business practice” and tended not to give the grounds for the conclusion explicitly (van der Zanden [2004a] p.168; *See also* Meeles [1979] p.145).

While accountants hoped that its pronouncements of the Tripartite Study Group would be supported by the verdicts of the Companies and Business Court (Burggraaff [1977] p. 275), the Companies and Business Court has not necessarily rely upon the views of the Tripartite Study Group or the Guidelines of the Annual Reporting Council and, in some cases, has taken a different view from that contained in the Guideline (Volton [1979] p. 20; Klaassen [1980]pp. 330 and 340; Burgert [1981] pp.54–55; Bollen and Lin-van Nuffel [1997] p.64). The Companies and Business Court was unenterprising to admit the authority to the Guidelines. This might be partly because the Tripartite Study Group and the Annual Reporting Council have a private nature, and partly because there was not enough transparency in the drafting process of the Guidelines (van der Zanden [2004a] p.168).

For example, the court decided, without referring to the Guidelines, in *Douwe Egberts* (Companies and Business Court, 20 January 1977), *Sekisui Systeembouw* (NJ 1978, 441), *Homburg* (NJ 1978, 442) and *GKN*(NJ 1986, 307). Moreover, before the 1985 decision of the Board of Appeal, the Companies and Business Court mentioned explicitly to the pronouncements of the Tripartite Study Group solely in *HBG (Hollandsche Beton Groep)* case²⁰ decision (4 February 1982), in which the Court held that the accounting treatment adopted by *HBG* relied upon the pronouncements of the Tripartite Study Group had not

19 For the details of the cases before 1970, *see e.g.* Camfferman [2007].

20 In this case, the issue was whether the *HBG*'s accounting treatment violated the Civil Code. *HBG* did not reflect write-downs of the shares in *NMMZ* arising from the reorganization of *NMMZ* in an income statement, but directly deducted from the reserve. In other words, the issue in this case was the choice between current operating performance theory and all-inclusive theory of an income statement. The pronouncements of the Tripartite Study Group provided that deducting extraordinary losses directly from equity capital is allowed even exceptionally.

given an insight required by Article 2:335 of the Civil Code and should be rejected²¹.

Moreover, *Mok*, the Advocate General of the Supreme Court was of the view that the Companies and Business Court needed to follow neither the pronouncement of the Tripartite Study Group nor the International Accounting Standards incorporated in the former²².

In the same way, *Ruiter*, the Minister of Justice noted in the response of 9 May 1978 that how the court made use of the Observations of the Tripartite Study Group at its sole discretion and it did not have to take them into account (*Handelingen*, Tweede Kamer, 1977-1978, Aanhangel, p.2053)²³.

4 Trend of doctrines before the 1985 decision of the Board of Appeal

While issues for the authority of the Guideline were brought up in Parliament in the course of implementing the EEC Fourth Company Law Directive²⁴, the Minister of Justice represented his perception that the Guideline would not be applied mandatory²⁵.

Moreover, for example, *Klaassen* noted that the Tripartite Study Group was “only a private group, there is no reason why the court must render its decisions in conformity with” the Group’s “accounting standards. The court must only apply the law, and accounting standards clearly have a lower status than the law” (*Klaassen* [1980] p.338). Before the 1985

21 *Vulcaansoord* decision held that the financial statements that had been prepared in accordance with the Observations of the Tripartite Study Group were insufficient while it did not mention explicitly to the Observations (van Aanhold en Graafstal [1978] pp.45-46).

22 NJ 1979, 373 *Douwe Egberts*. The issues in this case were (1) whether the funds statement is part of the financial statements; and (2) whether futures contracts for raw material (coffee and tea) should be disclosed in the notes. The Companies and Business Court ordered the defendant to disclose (1) the required supplementary information because the defendant presented the funds statement in a section of the annual report under the heading of the financial statements while the Annual Accounts Act did not mentioned the fund statements and (2) the current purchase and sales contracts, an indication of the valuation bases applied to these contracts and, if any, the effects on net income since disclosing inventory at hand only provided insufficient information for users of financial statements to form a judgment on the company’s net worth, its solvency and liquidity for companies that often have positions in commodities futures like the defendant (Decision of 20 January). The Supreme Court ordered the defendant to provide additional information similar to those the Companies and Business Court ordered to furnish (Decision of 17 January).

23 Some found this interpretation made by the Minister of Justice unsatisfactory (W.J.S.[1978] p.216).

24 *Handelingen*, Tweede Kamer, 1982-1983, 4473 [Van Dis].

25 *Handelingen*, Tweede Kamer, 1982-1983, 4543 [Korthals Altes].

decision of the Board of Appeal, on the binding power of the Guideline of the Annual Reporting Council, *Maeijer* pointed out that the Guideline of the Annual Reporting Council “could be deemed neither as legal rules nor objective principles without doubt. In cases where the judges hold that the Guidelines are deemed as the fundamental norm contained ultimately in the law, and condensed and reduced into a subordinate norm having the legal significance, the rules in Article 48 of the Civil Procedures Code would apply.” (*Maeijer* [1981] pp.31–32)²⁶. Other than *Maeijer*, few had discussed this issue but *Nagelkerke* had done in detail as follows: The Guidelines bind the Companies and Business Court, annual reporting legal entities, the auditors thereof and others while the views of the Tripartite Study Group have neither legal power nor formal legal authority (*Nagelkerke* [1982]). Therefore, even if the NivRA withdraws the Discussion Draft No.15, the pronouncements of the Annual Reporting Council would be deemed as the rules having a reflective effect since an obvious (flagrant) violation of the pronouncements of the Annual Reporting Council would be considered as non-compliance to the requirement for accuracy (*zorgvuldigheid*) adapted to the social climate, through the norms of conduct in the meaning of Article 1401.

Nagelkerke was of the opinion, however, that on the premise that there is the freedom of choice to a certain degree, the violation must be apparent (evident), using the expression “obvious (flagrant)”. Thus, we can understand that the view of *Nagelkerke* was that the views of the Annual Reporting Council have no binding power unless the deviation from the views cannot be justified (onjust). This means that any departures from the Guidelines are illegal only in cases where any accounting methods other than those indicated in the Guideline are not derived from reasonable corporate management.

5 1985 decision of the Board of Appeal and response to the decision

(1) 1985 decision of the Board of Appeal

Though *Groeneveld* already noted in the commentary on the decisions of the

²⁶ Article 48 of the former Civil Procedure Code stipulated that the judge fills legal grounds (*regtsgronden*) by his own authority and without any party’s request. Article 25 of the current Civil Procedure Code is the corresponding provision.

Disciplinary Board that there existed a clear consensus among the verdicts of the Companies and Business Court, the decisions of the Disciplinary Board and the Observations (Groeneveld [1980] p.10), the Disciplinary Board had not referred to the Observations of the Tripartite Study Group until 1984.

The Board of Appeal (Raad van Beroep)²⁷ of the NIVRA in the decision of 20 May 1985 upheld the decision of the Disciplinary Board of 27 May 1984, which held that the auditor should have examined whether the annual accounts had complied with the Guideline for Annual Accounts. It noted that the auditor in the case should have consulted and should have complied with the Guideline of the Annual Reporting Council (*Jurisprudentie Tuchtrechtspraak*, 1986-3). *Burggraaff* regarded this as signalling the end to unrestricted freedom and delivered an observation that all auditors would need to take this verdict into account in the future as this was the first decision of the Disciplinary Board on the Guideline (Burggraaff [1986]p.11)²⁸.

(2) Conflict of doctrines

Since *van der Grinten* voiced an opposition to the 1985 decision of the Board of Appeal, debates over the binding power of the Guideline of the Annual Reporting Council became active.

1) van der Grinten

Firstly, *van der Grinten* argued that the Guidelines have no binding power and carry no weight other than that of the view of an expert author (van der Grinten [1986] p.153). In other words, the Council for Annual Reporting is a private, without public nature, foundation that has no statutory status, has not been granted any authority by statutes, and in whose organization or composition no governmental agency involves. Secondly, he noted that the Council for Annual Reporting has no legislative authority and that the Guidelines are not more than the opinions common among a lot of experts and have similar weight as those of other experts groups. Lastly, the Council for Annual Reporting has no authority to

27 For details of the disciplinary actions against registered accountants in the Netherlands, see e.g. Blij *et al.* [1998].

28 The decision of the Disciplinary Board of 12 September (*Jurisprudentie Tuchtrechtspraak*, 1987-11) completely ignored the International Accounting Standards since there was no Guideline for Annual Reporting on that issue. See Burggraaff [1987] p.10.

develop standards to be applied in preparing annual accounts or to be complied with by auditors in carrying out audits but may give opinions on the interpretation of statutory regulation on the annual accounts, which bind nobody. *van der Grinten* concluded that the Board of Appeal should have looked at whether or not in compliance with the law and that this decision would not bind any auditors other than the auditor to whom this decision directed to²⁹.

Moreover, He insisted that the Council for Annual Reporting (RJ) “would do well of it made clear the character of its pronouncements. It cannot create norms. It does not have the authority to create binding interpretations of the law on financial statement. It can give advice and make recommendations. It might be expected that the RJ would not lead to a confusion over the nature of its Guidelines. Using the word Guidelines is already rather unfortunate. This term suggests that the RJ’s opinion is more or less binding for the business and the auditors” (*van der Grinten* [1986] p.155).

2) *van der Wel*

While *van der Wel* showed the same understanding that the Guidelines of the Council for Annual Reporting have no legal binding power³⁰, he nonetheless placed the Guidelines above other literatures in general (*van der Wel* [1987] pp.74 en 76).

3) *Koning*

In the context of the remark made by Minister *Polak*, *Koning* argued that the Guidelines of the Council for Annual Reporting as organizational norms among those who have different interests are justified by delegated legislation (*terugtrek*) by the Legislators. He noted that the views of the Council for Annual Reporting would have the authority by the process of the development in particular and pointed out that there exists the procedure of invitation to comments on the draft. Moreover, he remarked that it could not be denied that the Guidelines lead to the necessity for amendments to laws though they have no binding power. Furthermore, he argued that it is expected that the Legislators will intervene

²⁹ He noted, however, that it is possible that the impact of this precedent cannot be ignored.

³⁰ *Wessel* [1987] was of the same view. *Burgert* and *Timmermans* noted that the Guidelines have an authority derived from (*ontlenen*) their intrinsic value (*innerlijke waarde*) (*Burgert en Timmermans* [1989] I-55). It can be assumed that this statement is made in accordance with the response of the Minister of Justice *Ruiter* of 9 May 1978 (*Handelingen*, Tweede Kamer, 1977–1978, Aanhangsel, p.2053): “The Observations of the Tripartite Study Group, which are not binding, derive their authority from their intrinsic value”.

in cases where the authority of the Guidelines is sufficiently high. He lastly said that flexibility of the guiding principles is preferred in this area (Koning [1987] p.39).

4) IJsselmuiden

IJsselmuiden insisted that considerable authority should be attributed to the Guidelines. The Guidelines form a part of the legal requirements to the extent that parts of the Guidelines were seen as constituting “principles that are considered acceptable in the economic and social climate”, which might be inferred by their concurrence with international usage. He argued, therefore, that departure from such Guidelines should be indicated in an audit report as being deviation from the law (*IJsselmuiden* [1989]pp.278–279).

IJsselmuiden pointed out that Article 9, paragraph 2 of the Vienna Sales Convention (United Nations Convention on Contracts for the International Sale of Goods) stipulates that the parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned and Article 1054, paragraph 1 of the Dutch Civil Procedure Code (The arbitral tribunal shall decide according to the rules of law.) is regarded as referring to the Vienna Sales Convention with regard to arbitration on international transactions. He was of the view that generally accepted accounting principles form a part of *lex mercatoria*. He argued that accounting regulations (*jaarrekeningenrecht*) comprise a part of the international legal order since annual accounts have international nature with a twofold significance: annual accounts are tools for international legal relationship and the mechanism of annual accounts are defined by the rules that are international in nature and origin. He noted that accounting regulations are intended as a complement to the very simple provisions of the laws and regulations and they have been deducted primarily from the rules as generally accepted practices.

He argued as well that both the Guidelines of the Annual Reporting Council and those of the International Accounting Standards Committee have a binding power on two grounds: Firstly, they have standing in law. The norms stipulated in the Guidelines can be deemed as acceptable, in principle, in the social climate while Article 2:362, paragraph 1 of the Civil Code provides that annual accounts should give insights in accordance with acceptable

norms in the social climate. Secondly, the Guidelines have a binding power based on the fact that they are recognized as rules that have a binding power by the interested parties and are complied with in preparing annual accounts.

On the basis of the consideration above, *Ijsselmuiden* concluded as follows: (1) the organ of a legal person that prepares the annual accounts should comply with the Guidelines in cases where the Guidelines does not contradict the language, the principles or the system of statutes and have a character as generally accepted accounting principles; (2) Unqualified opinion is expressed when the annual accounts are prepared in accordance with the legal regulations and the Guidelines that meet the prerequisites pointed out in (1) above are also “law” for the purpose; (3) the accountant should consider whether the Guidelines are conformance to the laws and the generally accepted accounting principles even if he/she does not directly apply the Guidelines; (4) According to Article 999, paragraph 1 of the Civil Procedure Code, the Companies and Business Court shall assess whether annual accounts and annual reports have been made in accordance with the law and verify whether the Guidelines form a part of the generally accepted accounting principles; (5) Since it is a question of law whether the Guidelines are included in the legal norm, the Companies and Business Court should investigate *ex officio* independently in accordance with Article 48 of the Civil Procedure Code.

5) Schoonderbeek

While *Schoonderbeek* noted that neither the Observations of the Tripartite Study Group nor the Guideline of the Annual Reporting Council are mandatory, he represented the view that “they derive their prestige from the experts participating in the Council, from the involvement of users, preparers and auditors, and especially from the quality of the contents of the Guidelines”, citing a remark made by the Chairman of the Companies and Business Court that they can be described as authoritative opinions. Moreover, he observed that there can be no doubt that the “Observations” of the Tripartite Study Group and the Guidelines of the Council for Annual Reporting have influenced financial reporting practices in the Netherlands and the majority of companies had complied with most of the positive pronouncements and recommendations (*Schoonderbeek* [1992]p.77).

6 Foundation for Annual Reporting and Annual Reporting Council

(1) Foundation for Annual Reporting

In September 1981, the Foundation for Annual Reporting (Stichting voor de Jaarverslaggeving) was established by the Confederation of Netherlands Industry (VNO), Christian Employers' Organization (NCW), Federation of Netherlands Trade Unions (FNV), National Federation of Christian Trade Unions in the Netherlands (CNV) and the Netherlands Institute of Registered Accountants (NivRA). Later, the Dutch Association of Investment Professionals (VBA) from 11 December, 2002, the Netherlands Organization of Accountant Consultants (NOvAA) from 1 July 2002, the Association of Small and Medium-sized Enterprises (MKB) from 1 October 2002, and Eumedion from 2007 joined respectively in the management board of the Foundation for Annual Reporting. The aim of the Foundation for Annual Reporting is to enhance the quality of external reporting, especially of the financial statements of legal persons and other economically important organizations within the Netherlands. In order to realize the aim, the Council for Annual Reporting publishes authoritative pronouncements and recommendations on external reporting³¹ and submits, either on its own initiative, or at the request, opinions to the Government and other regulatory bodies on the requirements on external reporting. The Foundation for Annual Reporting has been financed by the NivRA and the NOvAA³² by one-third and by the Social and Economic Council (Sociaal-Economische Raad, SER)³³ by

31 For example, *van Bruinessen* (President the NivRA in 1970) opined in 1979 that since setting accounting standards by an absolute professional organization is inappropriate and disciplining by the law is insufficient, discipline by way in the United States with the Financial Accounting Standards Board would be a better solution (Zünd *et al.* [1980] S.12).

32 The NivRA and the NOvAA were merged on 1 January 2013 to become the Netherlands Institute of Chartered Accountants (Nederlandse Beroepsorganisatie van Accountants (NBA)).

33 The Social and Economic Council (SER) was established by the Industrial Organization Act (Wet op de bedrijfsorganisatie) and advises (upon request or at its own initiative) the Government and the Parliament on all major national and international social and economic issues and policies. It is wholly independent from the Government and is financed by industry. It also has an administrative role, as instituted by law. For example, it monitors commodity and industrial boards (product- en bedrijfsschappen, PBO's), which are responsible for representing the general interests of particular branches. These boards are made up of both employers' representatives and union representatives. In addition, the SER assists the Government in implementing the Works Councils Act (Wet op de ondernemingsraden). In this way, the SER is an advisory body and comments on draft bill to be tabled at the Parliament. It is, however, pointed out that it never paid particular attention to these

two-thirds (Schoonderbeek [1992] p.73, Zeff *et al.*[1992]p.276) until 2007. The NBA, Eumedion and the SER contribute to the Foundation's budget now.

(2) Annual Reporting Council

The Council for Annual Reporting (CAR) is composed of three delegations: consisting of representatives from (1) preparers, (2) users (three members representing trade unions and one member representing the organization of securities analysts³⁴) and (3) the auditors of financial reporting. Each delegation consists of four members, and (optional) a delegation employee. An independent chair is appointed for the Council by the Foundation. The meetings are attended by an observer from the Ministry of Justice and the Financial Markets Authority (Autoriteit Financiële Markten, AFM). The Council is also assisted by a secretary and a secretariat.

The Council meets once a month (two sessions), or otherwise as often the chairman, two members of the Board or the Board of the Foundation's request. The Articles of Association contain provisions on the Council decision making. Though each delegation has veto, almost never have voted and consultations have continued until a compromise is reached in practice (consensus or harmony model) (*See* Schoonderbeek [1992] pp.75–76).

matters while it is formally involved in the process of financial reporting regulation (Bollen and Linvan Nuffel [1997] p.63).

The SER consists of three groups (representatives of employers, representatives of employees and crown members (Kroonleden)), each with 11 members, making up a total of 33 members. The members representing employers are composed of 7 members from the VNO/NCW, 3 from the MKB and 1 from the Dutch Organization for Agriculture and Horticulture (LTO) while those representing employees are composed of 8 members from the FNV, 2 from the CNV and 1 from the Federation of Managerial and Professional Staff Unions (MHP). The crown members are appointed with special care to maintain a fair balance between the various fields of interest and political views in the country and often university professors with a chair in economics, finance, law or sociology while the President of the Netherlands central bank (De Nederlandsche Bank), and the Director of the CPB Netherlands Bureau for Economic Policy Analysis (Centraal Planbureau) are both Crown members. The President of the SER is also appointed by the Crown, on the SER's advice. The President's post is a full-time post while all other SER members are part-time members.

The SER meets on the third Friday of every month, primarily to discuss and finalize the SER's advisory reports to the Government. Prior to this stage, the reports are prepared and intensively discussed in a committee or working party. These meetings are open to the public. Where the SER's advice is not unanimous on all points, the differences of opinion are set out in the report.

³⁴ Schoonderbeek remarked that participation of investors and securities analysts would further strengthen the Council's base (Schoonderbeek [1992]p.77).

7 Amendments to cope with the introduction of the International Accounting Standards

It was pointed out even in 1996 that departures from the Guideline “are not disclosed, ... either in the annual accounts or in the audit report, so that users are unable to ascertain compliance with” the Guideline (Hoogendoorn [1996] p.872).

The Bill amending Book 2 of the Civil Code concerning the use of the International Accounting Standards³⁵ proposed, however, that whether annual accounts have been prepared in accordance with the Guideline of the Council for Annual Reporting should be disclosed in the notes. The first Bill introduced to the Parliament proposed that new Article 2:362, paragraph 10 of the Civil Code stipulated that “the legal person shall mention in the notes on which standards annual accounts were prepared” and “it shall also state whether the financial statements are prepared in accordance with the Guidelines for annual reporting established by the Council for Annual Reporting if the provisions of Section 3 to 6 of this title apply” (*Voorstel van Wet*, Tweede Kamer, 2001–2002, 28 220, nr. 2, p. 2).

The grounds for this proposal were as follows (*Memorie van Toelichting*, Tweede Kamer, 2001–2002, 28 220, nr. 3, pp. 9–10):

Now that the law expressly permits two accounting standards next to each other, it is all the more important that a legal person clearly informs its choice to the user of the financial statements. Therefore, paragraph 10 requires the entity to indicate in the notes based on which standards the financial statements are prepared. In addition, it is also proposed that the legal person that reports according to Book 2 is obliged to indicate whether it has prepared in accordance with the Guidelines for Annual Reporting. An entity is not required to follow the Guidelines exactly (precies) and may have good reasons not to be bound by the orientations provided by the Council for Annual Reporting. It shall, however, provide clearly thereabouts. The users of financial statements should be able to ascertain whether an entity has followed the Guidelines. If that is not the case, then the interested parties are free to ask the management board and the supervisory board, if any, for the explanation thereto.

35 28 220 Wijziging van boek 2 van het Burgerlijk Wetboek in verband met het gebruik van internationale jaarrekeningstandaarden.

The obligation to provide the basis on which standards in the financial statements were prepared had already existed for companies with international branches and using the option in Article 2:362, paragraph 1 of the Civil Code. By applying the new paragraph 10 to all companies, this sentence would be omitted.

Because the use of IAS is explicitly allowed, the norms contained in these standards as they were interwoven in our system. They become a part of the Dutch legal requirements. This means among other things that the auditor referred to in Article 2:393 should examine whether the financial statements give insight required in Article 2:362, paragraph 1, Civil Code and the proposed article. It cannot be sufficient, therefore, merely to state that the financial statements have been furnished according to the IAS. It would not be desirable now in Europe that the financial statements must be complied with the provisions of the Fourth and Seventh Directives. The entity is required to give under which system of norms (normenstelsel) and standards it reports. The auditor verifies the accuracy of this statement.

In addition, it was noted that while the Guidelines of the Council for Annual Reporting have no legal power, “for the time being, a legal entity departs from the Guidelines must have special reasons in light of social views. It is also obvious that this will also be on the agenda in cases where the discussion of the financial statements in the General Shareholders Meeting or the Works Council become the subject (*Memorie van Toelichting*, Tweede Kamer, 2001–2002, 28 220, nr. 3, p.12).

The Minister of Justice submitted, however, in the course of the debate, an amendment to delete the second sentence “within the framework of the constraints on the mission of the government” (*Derde Nota van Wijziging*, Tweede Kamer, 2001–2002, 28 220, nr. 11, p. 1) was made and later this Bill was withdrawn³⁶.

In the reintroduced Bill³⁷, the newly proposed Article 2: 362, paragraph 10 of the Civil

36 <<http://www.eerstekamer.nl/9324000/1/j9vvgvh5ihkk7kof/vgxsn1p6smbj>>.

37 29 737 Wijziging van boek 2 van het Burgerlijk Wetboek ter uitvoering van Verordening (EG) Nr. 1606/2002 van het Europees Parlement en de Raad van 19 juli 2002 betreffende de toepassing van internationale standaarden voor jaarrekeningen (Pb EG L 243), van Richtlijn nr. 2001/65/EG van het Europees Parlement en de Raad van 27 september 2001 tot wijziging van de Richtlijnen 78/660/EEG, 83/349/EEG en 86/635/EEG met betrekking tot de waarderingsregels voor de jaarrekening en de geconsolideerde jaarrekening van bepaalde vennootschapsvormen evenals van banken en andere financiële instellingen (Pb EG L 283), en van Richtlijn 2003/51/EG van het Europees Parlement en de Raad van 18 juni 2003 tot wijziging van de Richtlijnen 78/660/EEG, 83/349/EEG, 86/635/EEG en 91/674/EEG van de Raad betreffende de jaarrekening en de geconsolideerde jaarrekening van

Code only required a legal person to mention in the notes on which standards the annual accounts were prepared (*Voorstel van Wet*, Tweede Kamer, 2003–2004, 29 737, nr. 2, p. 2)³⁸, and, thus, the current Article 2: 362, paragraph 10 of the Civil Code provides that way. It is considered that an informal lobbying to the Minister of Justice and other movements had lead to this modification³⁹.

As the interpretation of the provisions of the current law, it is widely accepted that in cases where a company should choose to depart from the Guidelines despite it states that it follows the Guidelines for Annual Reporting, it shall disclose that fact and explain⁴⁰.

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bepaalde vennootschapsvormen, banken en andere financiële instellingen, en verzekeringsondernemingen (Pb EG L 178) (Wet uitvoering IAS-verordening, IAS 39-richtlijn en moderniseringsrichtlijn).

38 The Explanatory Memorandum said that “Now that the law expressly permits two accounting standards next to each other, it is all the more important that a legal person clearly informs its choice to the user of the financial statements. Therefore, paragraph 10 requires the entity to indicate in the notes based on which standards the financial statements are prepared” (*Memorie van Toeliching*, Tweede Kamer, 2003–2004, 29 737, nr. 3, pp. 17–18).

39 According to the advice by *van der Zanden* (1 February 2008), many informal contacts that have been made to the Minister of Justice and the employees’ representatives in the Council for Annual Reporting were against the first draft.

40 According to the advice by *van der Zanden* (1 February 2008).