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**COMMISSION STAFF WORKING PAPER**

**Part I**

# IMPACT ASSESSMENT

***Accompanying the document***

**Proposal for a Directive of the European Parliament and the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings**

{COM(2011) 684 final}
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## 1. INTRODUCTION

The Fourth Council Directive 78/660/EEC on annual accounts and the Seventh Council Directive 83/349/EEC on consolidated accounts (hereafter the "Accounting Directives" or "Directives")[1] deal with the annual and consolidated financial statements of limited liability companies in Europe. During the past 30 years, amendments to the Accounting Directives[2] have added many requirements, such as new disclosures and valuation rules, including detailed provisions on fair value accounting. Less attention has been paid to considering whether existing requirements could be simplified or removed. Whilst every amendment may have been justified in its own right, these additions have led to increased complexity and regulatory burden for companies.

Since listed companies became subject to the IAS regulation in 2005[3], SMEs have become *de facto* the main users of the Accounting Directives. Small and medium-sized companies, which are the backbone of the European economy and the main contributors to the creation of employment in the EU, have especially felt the impact of these new requirements. The Commission is committed to release the growth potential of these companies by reducing the administrative burden by 25% by 2012[4]. The Commission's approach is outlined in the Europe 2020 Strategy[5] which aims to make the EU a smarter, more sustainable and inclusive economy, as well as in the Single Market Act[6].

Developments in the business environment and users' needs have resulted in situations where the reporting requirements of the Accounting Directives no longer effectively match users' needs. These needs differ depending on the size or other features of companies, whereas the Directives tend to address this in an uneven and complex manner. Yet, any financial statement must remain useful and

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1 See Annex 1 "Legal environment in the EU". The Accounting Directives comprise the following legislation: Fourth Council Directive of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies (78/660/EEC), available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:01978L0660-20070101:EN:NOT; Seventh Council Directive of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts (83/349/EEC), available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:01983L0349-20070101:EN:NOT

2 For previous amendments to the 4th Directive, see http://ec.europa.eu/internal_market/accounting/legal_framework/annual_accounts_text_en.htm. For previous amendments to the 7th Directive, see http://ec.europa.eu/internal_market/accounting/legal_framework/consolidated_accounts_text_en.htm

3 See http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2002R1606:20080410:EN:PDF

4 The Commission introduced in 2006 a distinction between administrative costs and administrative burdens: the latter designate costs specifically linked to information that businesses would not collect and provide in the absence of a legal obligation. For more information see http://ec.europa.eu/governance/better_regulation/admin_costs_en.htm

5 More details about the Europe 2020 strategy are available at http://ec.europa.eu/europe2020/index_en.htm

6 See Communication of April 2011 from the Commission to the Council, the European Parliament, The European Economic and Social Committee and the Committee of the Regions: "*Single Market Act – Twelve levers to boost growth and strengthen confidence, 'Working together to create new growth*'", available at http://ec.europa.eu/internal_market/smact/docs/20110413-communication_en.pdf#page=2

understandable to the intended users. The acknowledgment of the distinct needs of the SME group as well as the segments within that group have been clearly addressed through the "think small first" principle enshrined in the Small Business Act (SBA) of June 2008[7]. Applying this principle should lead to differentiated and simpler reporting requirements for smaller companies and to a new structure of the Directives.

The revision of the Accounting Directives is part of the Commission's Simplification Rolling Programme and Administrative Burden Reduction initiatives for 2011. This impact assessment presents the Commission's initiative to modernise and simplify the financial reporting requirements so as to make them less burdensome whilst ensuring they remain fit to users' needs. The work has been guided by the "think small first" principle.

## 2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

### 2.1. Policy context

Under the Europe 2020 Strategy, the single market should be deepened by streamlining single market rules and harmonising where rules differ between Member States. The Industrial Competitiveness side of the strategy encourages "fitness checks" of existing legislation to identify the potential for reducing the cumulative effects of legislation so as to cut costs for European business. Work is also needed to improve access to the single market for small businesses and to develop entrepreneurship, in part by simplifying company law.

Moreover, the Commission's Smart Regulation strategy[8] is aimed at designing and delivering regulation of the highest quality, respecting the principles of subsidiarity and proportionality, whilst ensuring that administrative burdens are proportionate to the benefits they bring. The Commission's political will to recognise the central role of SMEs in the EU economy is also reflected in the "Small Business Act", which has the objectives of improving the overall approach to entrepreneurship and anchoring the "*think small first*" principle in policy-making from regulation to public service. In this respect, the Single Market Act stresses the need to reduce the regulatory burden,

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7 See Communication of 25 June 2008 from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on "Think Small First, a Small Business Act for Europe", COM(2008) 394 final, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0394:FIN:en:PDF and http://ec.europa.eu/enterprise/entrepreneurship/docs/sba/report_think_small_first.pdf. See also http://ec.europa.eu/enterprise/entrepreneurship/think_small_first.htm

8 See Communication of 8 October 2010 from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on "*Smart Regulation in the European Union*", COM(2010)543. In order to improve existing legislation the Commission has inter alia put in place the Action Programme for Reducing Administrative Burdens, COM (2007)23, which is on track to exceed its target of cutting red tape by 25% by 2012 (see Press Release IP/10/1670 of 7 December 2010 "Good progress in cutting red tape" available at http://ec.europa.eu/enterprise/policies/better-regulation/administrative-burdens/index_en.htm

in particular for SMEs, at both European and national levels, and calls for a simplification of the Accounting Directives[9].

The Commission issued a Communication putting forward several ideas for simplifying the current accounting requirements for SMEs in July 2007[10], and followed this up by proposing a number of targeted simplification measures which were adopted by the co-legislators in June 2009.[11] In May 2008, the European Parliament welcomed the objectives of reducing administrative burdens and enabling SME's to compete more effectively[12], encouraging the Commission "to continue its activities with regard to the simplification of company law, accounting and auditing for SMEs via the relevant legislative acts, in particular the Fourth and Seventh Company Law Directives"[13].

Most of the suggestions presented in the Communication were then taken up by the *High Level Group of Independent Stakeholders on Administrative Burdens* in its Opinion of July 2008[14]. In view of strong stakeholder support for further simplification for SMEs, the review of the Accounting Directives began. Later in the same year the European Parliament reiterated its support for a simplification initiative in this field[15].

The Commission published on 26 February 2009 a proposal for exempting micro companies[16] from the scope of the Fourth Directive. This proposal received strong

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9 The Single Market Act flags as a key action in section 2.11 the simplification of the Accounting Directives as regards financial information obligations and reduction of the administrative burden, particularly for SMEs.

10 For more details see "European Commission: Simplifying the business environment for companies", available at http://ec.europa.eu/internal_market/company/simplification/index_en.htm

11 See Directive 2009/49/EC of the European Parliament and of the Council of 18 June 2009 amending Council Directives 78/660/EEC and 83/349/EEC as regards certain disclosure requirements for medium-sized companies and the obligation to draw up consolidated accounts (Text with EEA relevance), available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32009L0049:EN:NOT

12 See resolution of the European Parliament of 21 May 2008 (A6-0101/2008) on a simplified business environment for companies in the areas of company law, accounting and auditing (2007/2254(INI)), available at http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2008-0220+0+DOC+XML+V0//EN

13 See resolution of the European Parliament of 24 April 2008 on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB) (2006/2248(INI)), available at http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2008-0183+0+DOC+XML+V0//EN

14 For more details see http://ec.europa.eu/enterprise/admin-burdens-reduction/highlevelgroup_en.htm

15 On 18 December 2008, the European Parliament adopted a non-legislative Resolution stating that the Accounting Directives are "*often very burdensome for small and medium-sized companies, and in particular for micro-entities*". In the same Resolution the Commission was asked "*to continue its efforts to review the Fourth and Seventh Company Law Directives*".

16 See Proposal for a Directive of the European Parliament and of the Council amending Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities, COM/2009/0083, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009PC0083:EN:NOT. The proposal defines Micro-Entities as companies which on their balance sheet dates do not exceed the limits of two of the three following criteria: balance sheet total: EUR 500.000, net turnover: EUR 1.000.000 and average number of employees during the financial year: 10.

support in the European Parliament[17]. Negotiations in the Council were still ongoing at the time of drafting this Impact Assessment. Proposals examined in this document should be seen as complementary to the 2009 proposal concerning micro-entities.

## 2.2. Consultation of Interested Parties

Since 2008 the Commission has continued to thoroughly consult with all interested parties. In particular, the following specific initiatives were undertaken:

- The setting up of an informal ad-hoc SME reflection group composed of 10 experts with diverse experience.[18]

- The conduct of two public consultations, respectively on the Review of the Fourth and Seventh Company Law Directives (February-April 2009) and on the International Financial Reporting Standard for Small and Medium-Sized Entities (November 2009 – March 2010). Both consultations were followed by stakeholders' meetings to consider and further discuss the results.

- Several targeted meetings with stakeholders, including national standard setters, representatives of small and medium-sized businesses, banks, investors and accountants across EU.

- Consultations with the EFRAG (European Financial Reporting Advisory Group) Working Group on SMEs and the Accounting Regulatory Committee (ARC) ad hoc Working Group on SMEs.

- A study into the effects on administrative burden from changes to Accounting Directives conducted in 2010 by the Centre for Strategy and Evaluation Services (CSES)[19]. The European Business Test Panel (EBTP)[20], a panel of enterprises set up by the Commission, was used to survey enterprises in the EU.

- A study on "Accounting requirements for SMEs, conducted by CNA Interpreta until 2011. The goals were (i) to provide an overview of existing accounting requirements and the perceived needs for accounting information from SMEs in Europe in the non-financial business economy from both the users' and preparers' point of view; and (ii) to come forward with concrete proposals on possible future accounting requirements for SMEs in the non-financial business economy[21].

These consultations indicated support from stakeholders for burden reduction measures, especially for the smallest companies, as well as a need to modernise the

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17 Full text of the resolution adopted by the European Parliament is available at http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2010-0052&language=EN&ring=A7-2010-0011

18 The group, set up in the end of 2008 to prepare the review of the Accounting Directives, met five times between December 2008 and February 2009.

19 Full text of the CSES study on " 4th Company Law Directive and IFRS for SMEs" (hereinafter "CSES Study") is available at http://ec.europa.eu/internal_market/accounting/docs/studies/2010_cses_4th_company_law_directve_en.pdf

20 http://ec.europa.eu/yourvoice/ebtp/index_en.htm

21 http://ec.europa.eu/enterprise/policies/sme/business-environment/accounting/

European accounting framework. More details on consultations are provided in Annex 2. Diverging views were expressed with regard to a number of policy ideas, especially about the potential adoption of the IFRS for SMEs (see Annex 3). The outcome of these consultations has been taken into account in this Report.

Finally, an Impact Assessment Steering Group gathering all relevant Directorates General was set up and convened on three occasions[22].

### 2.3. Recommendations of the Impact Assessment Board

The opinion of 11 March 2011 of the Impact Assessment Board of the European Commission [23] on an earlier version of this impact assessment was that the report provided adequate evidence to demonstrate the potential of a burden reduction initiative in the area of accounting, although certain issues had to be explained in a more transparent and balanced fashion so as to inform decisions about its finer details. Firstly, the impact assessment had to more carefully assess and explain the negative or uncertain impacts of its options, in terms of: the value of regulated accounts information, transition costs, demand for accountancy-related services and cost of statistical data collection. Secondly, the impact assessment had to specify which Member States are likely to be most affected, referring to the take-up of existing derogations under the baseline scenario and later using this and other evidence to give some indication about Member States where SMEs are most likely to see practical benefits or costs. Thirdly, the impact assessment had to more fully record the differences in stakeholder views. Finally, the impact assessment had to clarify the political context and intervention logic by explaining at an early stage both how this initiative relates to the related pending proposal on micro-entities and what is considered to be essential information in the context of accounts.

The present document has been updated to take account of the above-mentioned comments, especially in Sections 3, 5, 6 and in Annex 6.

## 3. PROBLEM DEFINITION

Financial statements consist of a Balance Sheet, which presents a company's assets and liabilities at the end of an accounting period, and the Profit and Loss account which presents the income and expenditure for the accounting period. Financial statements also include Notes that provide more detail on certain items presented in the Balance Sheet and Profit and Loss account.

### 3.1. The purpose, use and benefits of financial statements

The Directives oblige limited liability companies as defined in Article 1 of the Fourth Directive and certain other companies to prepare financial statements. Financial statements assist investors in making informed decisions on the allocation of capital.

22 The Impact Assessment Steering Group (IASG) included members from the Secretariat General, Legal Service as well as the following DGs: Economic and Financial Affairs; Enterprise and Industry; Eurostat; Taxation and Customs Union; Employment and Social Affairs; Trade; Health and Consumers. The group met on 31st May, 14th December 2010 and 17th January 2011.

23 Please refer to the following site: http://ec.europa.eu/internal_market/accounting/index_en.htm for the full text of the opinion of the Impact Assessment Board.

They convey information to those stakeholders that otherwise do not have access to the financial information of a company. Such stakeholders include shareholders, creditors such as banks for whom the financial statements may provide evidence on the ability of a borrower to service debt, and also other parties interested in the financial performance and position of a company such as tax authorities, clients, suppliers and other business partners, factoring companies, credit rating agencies, employees and the public at large. Other public bodies, for example statistical offices, may use financial statements as a source of data for micro and macro economic purposes.

Absent a 'think small first" approach when designing the Directives, no common sense has been developed so far in the EU as to whether there should be limits to the level of accounting obligations to be required from the smaller companies. The Directives themselves contribute to require many items, disregarding the size of companies. Exemptions to these requirements are offered in a number of areas for small companies, but are optional for the Member States. Nothing in the Directives prevents that small companies follow the same regime as that of larger companies.

Based on literature and own analysis (see Annex 4), a clear distinction tends to appear depending on the size of companies. The Commission Services consider that micro / small companies on the one hand, and medium-sized / large companies on the other hand, have different problems that need to be addressed. Therefore the analysis that follows will categorize according to these size groups[24]. This is important to consider, as given the limited resources of especially small companies, the challenge is to match the reporting requirements with the information needs of users. Some users who do not incur the cost of providing information may want to see information of only marginal value i.e. information which is "nice to have"[25]. However the information needs of users differ, especially in relation to the size of a company.

[24] See article 2 of Directive 78/660/EEC.
[25] See e.g. Knutson and Wichmann, 1984

The thresholds for the different categories of companies used in this impact assessment, using the current definitions in the Accounting Directives and the proposed definition for micro-companies of 2009, are as follows (at least two out of three criteria must be met):

**Table 1 - Thresholds for the different categories of companies.**

| Category / Threshold | Micro | Small | Medium |
|---|---|---|---|
| balance sheet total | ≤ € 500,000 | ≤ € 4,400,000 | ≤ € 17,500,000 |
| Net turnover | ≤ € 1,000,000 | ≤ € 8,800,000 | ≤ € 35,000,000 |
| Average number of employees during the financial year | ≤ 10 | ≤ 50 | ≤ 250 |

*Source: The Fourth Directive 1978, Communication from the Commission on a simplified business environment for companies in the areas of company law, accounting and auditing 2007. Proposal of 2009 for a Directive on micro-entities – 2009/0035 (COD)*

Depending on the purpose of EU policies, the Union may use definitions that differ to a certain extent from the above[26].

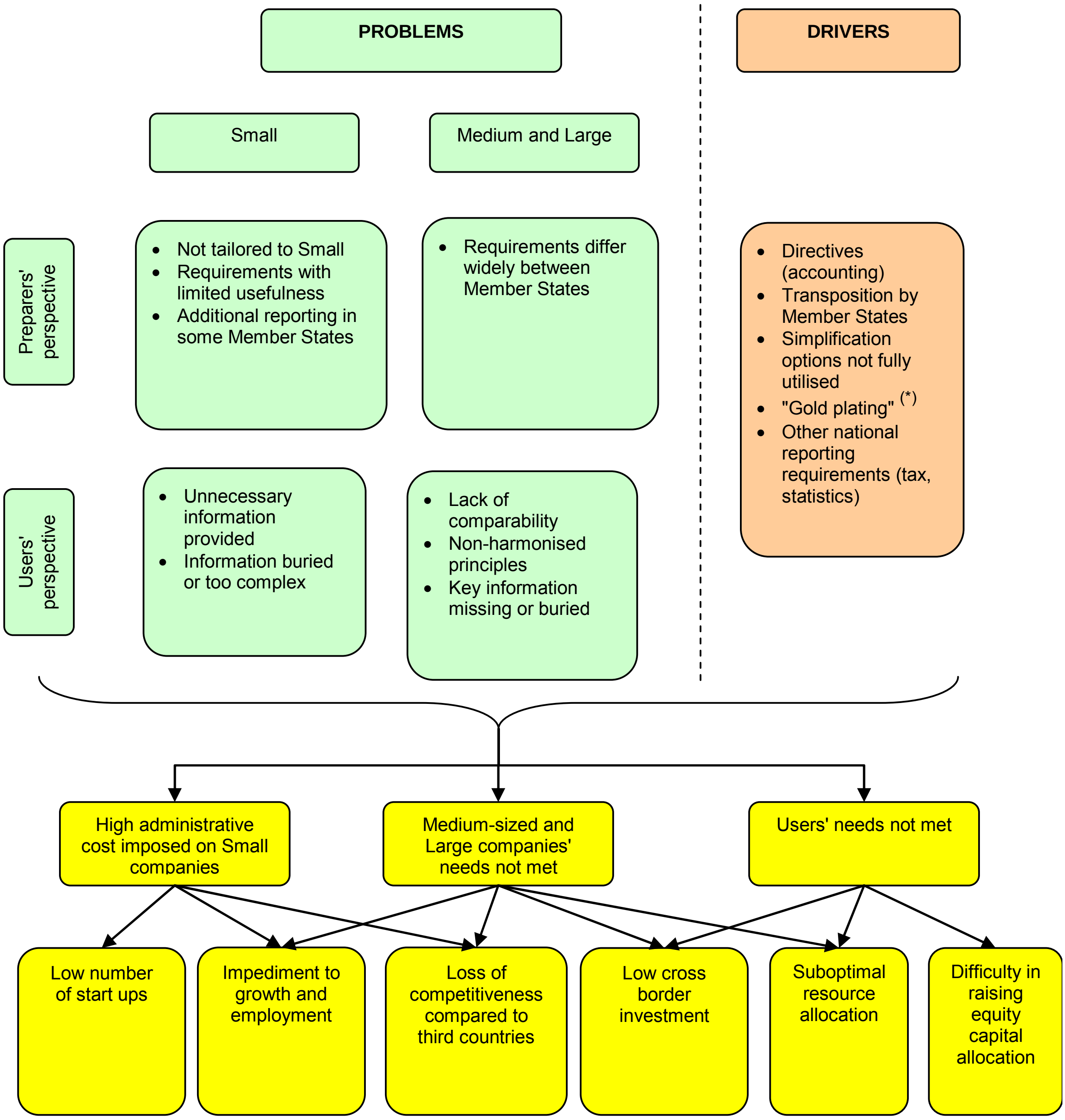
[26] For instance, the Commission promotes definitions of micro, small and medium-sized enterprises that are defined only for certain matters, such as State aid, implementation of the Structural Funds or Community programmes, particularly the Framework Programme on Research and Technological Development. These are given by the Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises [Official Journal L 124 of 20.05.2003]. Under this frame, a medium-sized enterprise is defined as an enterprise which employs fewer than 250 persons and whose annual turnover does not exceed EUR 50 million or whose annual balance-sheet total does not exceed EUR 43 million. A small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. And a microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million. See also http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm

In addition, given that, in other economically comparable jurisdictions and key trading partners of the EU, financial reporting requirements for small companies are generally less demanding than those imposed currently by the Accounting Directives[27], it seems appropriate to also examine whether the current EU accounting regime for the smallest companies is unnecessarily complex.

[27] See Annex 1 for further analysis.

Figure 1 below provides an overview of the problems:

Fig.1 – Overview of key issues




*Source: Commission own analysis*

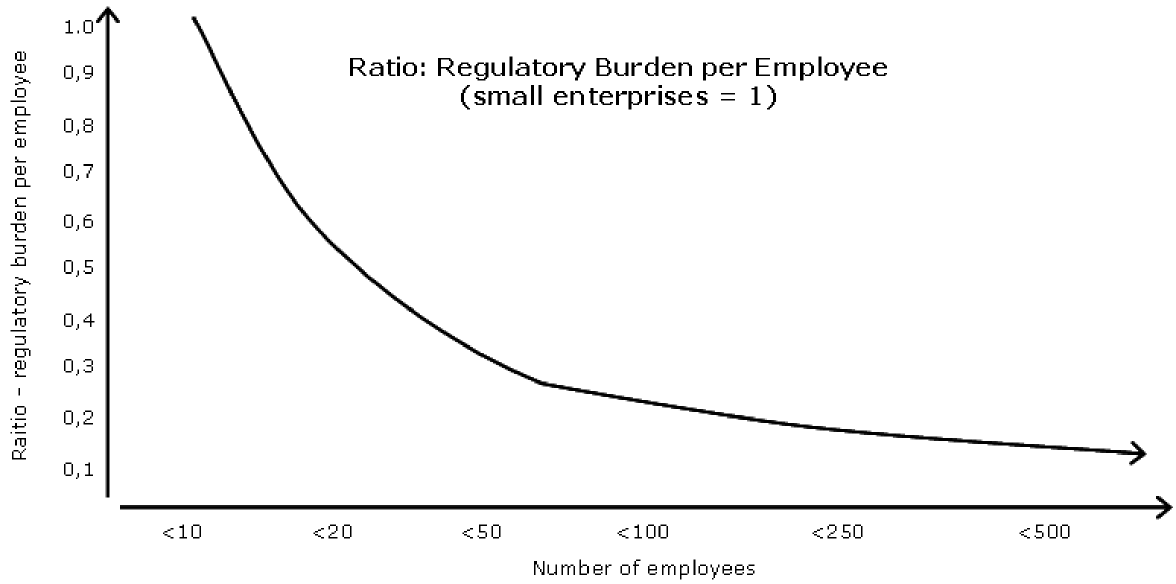
(*) 'Gold plating' is an expression used in the present impact assessment to describe the introduction by the Member States of accounting legislations that go beyond the EU requirements. Whether a Member State may make use or not of an option offered by EU legislation, including an option to exempt companies from an accounting obligation is not meant to be considered as 'gold plating'.

## 3.2. Preparers of financial statements: on the costs side

An expert group report[28] identified that on average, a business with fewer than ten employees has to face an administrative burden[29] (measured per employee) that is roughly twice as high as the burden of a business with more than ten but less than twenty employees and about three times as high as the burden of businesses with more than twenty but less than fifty employees. For bigger companies, the burden per employee is only one fifth or less of that of small enterprises. This is typically because a substantial part of the administrative cost is fixed.

In simple terms: where a big enterprise spends one Euro per employee to comply with a regulatory duty a medium-sized enterprise might have to spend around four Euros and a small business up to ten Euros. This is illustrated by Figure 2 below.

Fig. 2 - Administrative burden by company size




*Source: European Commission. 2007. Report of the Expert Group. Models to reduce the disproportionate regulatory burden on SMEs, p. 17.*

It appears that the relative burden tends to stabilize above 50 employees, which is one of the dividing lines between small and medium-sized companies in the Directive.

### *3.2.1. Rules not tailored to small companies*

National measurements carried out in the years until 2006 and the results of the stakeholder consultation identified company law, including the fields of accounting

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28 See Report of the Expert Group, Models to reduce the disproportionate regulatory burden on SMEs, European Commission, 2007, pp. 16-17, available at http://ec.europa.eu/enterprise/entrepreneurship/support_measures/regmod/regmod_en.pdf

29 Costs incurred only because of a legal obligation to provide information (without real business need to provide that information) constitute administrative burden. Such burden may arise not only from accounting, but also from other regulations such as tax, customs, social laws, etc.

and auditing, as one of the most burdensome areas of EU law[30] for smaller companies.

Recent studies[31] indicate that, given the numerous disclosure requirements currently in the Directives, the notes are laborious to comply with and preparing these represents the most time consuming part of the process especially for smaller companies. The notes are descriptive, require additional analysis and contain information that, most of the time, cannot be easily obtained from the accounting software. It is estimated that for small companies up to 50% of time spent on preparing financial statements is devoted to the preparation of notes. Even though the Member States are permitted to allow small companies to file abbreviated financial statements (a balance sheet with any notes pertaining thereto), the Directives require these same companies to prepare more detailed financial statements for their shareholders. The option offered to Member States to allow small and medium-sized companies to prepare abridged accounts does not prevent them from preparing fully fledged notes.

There is currently no general principle of materiality in the Directives. Materiality is a concept that would allow companies to dispense with separately presenting trivial or non-significant items in financial statements. Presenting non-material information entails unnecessary burden, and can lead to unnecessarily long and detailed financial statements.

### 3.2.2. *Requirements with limited usefulness*

The Directives require an Annual report from all companies, but allow the Member States to exempt small companies provided certain conditions are met[32].

Also, the Directives have a general requirement that the financial statements should be audited, whatever the size of the company. However, the Member States can exempt small companies. A number of Member States have chosen to not implement that option, leading to more than 170,000 small company statutory audits each year, at an annual cost of €0.5bn[33]. This has been identified as a burden by the High Level Group of Independent Stakeholders on Administrative Burdens, and is questioned in the Commission Green Paper on Audit of 13 October 2010[34].

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30 13 priority areas for better regulation have been selected by the European Commission based on a 2006 pilot study, including Annual accounts/company law, see http://ec.europa.eu/enterprise/policies/better-regulation/administrative-burdens/priority-areas/index_en.htm. This has been used by the High Level Group of Independent Stakeholders on Administrative Burdens as a reference, see http://ec.europa.eu/enterprise/policies/better-regulation/administrative-burdens/high-level-group/index_en.htm. See also EU Project on Baseline Measurement and Reduction of Administrative Costs, by Consortium (Capgemini, Deloitte, Ramboll), hereafter "Consortium", available at http://ec.europa.eu/enterprise/policies/better-regulation/documents/ab_studies_2009_en.htm#h2-1 under heading Annual Accounts / Company Law

31 See in particular CSES 2010 and Consortium 2009

32 See Article 46 of Directive 78/660/EEC

33 Ibid

34 http://ec.europa.eu/internal_market/consultations/docs/2010/audit/green_paper_audit_en.pdf, section 7.

### 3.2.3. *Requirements differ widely between Member States*

Currently there are around 80 significant options in the Fourth Directive on annual financial statements for Member States to choose, and about 40 options in the Seventh Directive on consolidated financial statements. Each option is utilized by at least one Member State.

Options generally relate to presentation, recognition, measurement and disclosure in financial statements. They often allow for totally different valuation rules, such as fair value or historical cost, or FIFO ("first in, first out") and LIFO ("last in, first out") method for stocks which results in financial statements that are not fully comparable. Furthermore options around presentation allow for different layouts to present accounting information. Differences can also be of more fundamental nature, such as whether the financial statements should reflect the economic reality of transactions rather than comply with their legal form[35]. More explanations on the "substance over form" principle are given in section 3.3.3 below.

This poses a problem for those companies that have subsidiaries in different Member States, as financial statements prepared under local accounting rules have to be reworked to produce consistent financial information suitable for the parent company to include in its consolidated financial statements. This also represents a non negligible hurdle to companies looking to expand their business cross border.

According to Eurobarometer[36], 19.9% of large and 8.2% of medium-sized enterprises have a foreign subsidiary, which contrasts with respectively 5.8% and 3.6% for small and micro enterprises. Additionally almost every third large (27.3%) and every fifth medium-sized (19.5%) company is a subsidiary itself, while these figures drop to 8.8% and 4.1% for small and micro ones respectively.

Whilst the Directives currently contain some simplified measures for smaller companies the Member States can set lower thresholds than those provided for in the Directives when defining small or medium-sized companies locally. As a result, companies that would be considered as small under the Directives are considered as medium-sized or even large companies under national law in many of Member States. These companies face more regulatory burden than that foreseen at EU level. Only eight Member States have transposed or are about to transpose the maximum amounts of turnover, balance sheet and headcount allowed for in the Directives[37]. Other Member States may use slightly to significantly lower amounts. This also affects competition between companies in the EU as the disclosure of sensitive business information can differ from one Member State to another for companies of the same size.

Options offered by the Directives to the Member States represent therefore an issue for many companies across the EU.

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35 See Article 4(6) of Directive 78/660/EEC.

36 Eurobarometer 2007, Observatory of European SMEs. Analytical report, pp. 56 and 100.

37 See Commission survey at http://ec.europa.eu/internal_market/accounting/docs/2010-options_en.pdf

## 3.3. Users of the financial statements: on the benefit side

### *3.3.1. Unnecessary information*

The literature and analysis support the comments from stakeholders that the financial statements often contain information that is of little relevance. This is especially the case with the standard disclosures required by the Directives[38], most of which are not used by banks or other stakeholders – banks often ask for other information instead. Feedback from stakeholders and expert groups[39] suggests that a number of these notes have only little informative value to stakeholders. This is also supported by literature on the SME user needs[40]. In short, for smaller companies the costs of preparing sophisticated and complex statutory financial reporting usually outweighs the benefits for the users.

In addition, absent a general principle of materiality in the Directives, as seen above, the chances of unnecessary information being produced are higher.

### *3.3.2. Key information hidden in notes due to numerous or complex disclosures*

For the users of smaller company financial statements, over-sophisticated and complex reporting requirements are less useful than simple and clear ones. Discussions with stakeholders suggest that the current complexity of financial statements can make them meaningless for small entrepreneurs. They often cannot understand the content of the financial statements without the advice of an analyst or accountant. Thus the usability of the financial statements for micro and small companies is reduced both for owners and for business partners. This lends support to the idea that small companies' accounting requirements should be simplified.

### *3.3.3. Lack of comparability, key information missing due to high number of options and non harmonized principles*

Because of the many options currently available to the Member States in the Directives, national accounting legislations are inconsistent in a number of areas across Europe. Non-harmonised principles can result in similar transactions being accounted for very differently across the EU. Both issues increase the lack of comparability of financial reporting across the Member States and hence can prevent optimal cross border investment decisions by the users.

Depending on the option retained, this may entail in addition key information to be missing in the financial statements.

For example, the "substance over form" principle is currently an option. This means that the Directives allow transactions to be accounted for according to their

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38 For example, small companies can be required to disclose particulars of share capital, which would already be in the public domain, having been filed at the Companies' Register. A further example: small companies can also be required to disclose details of deferred tax assets and liabilities, when the whole concept of deferred tax is not generally understood by the users of small company financial statements.

39 Namely the EFRAG SME Working Group, http://www.efrag.org/wg/detail.asp?id=67, and the ah hoc Working Group on SMEs established within the framework of the Accounting Regulatory Committee (ARC)

40 See in particular Eierle et al, 2009

*commercial substance* (or economic reality) or alternatively according to their *legal form.* This can lead to quite different presentations of similar transactions from one company to another. Leasing transactions are a good example of where the legal form and commercial substance of a transaction can differ quite markedly. Take the example of a lease of a machine over its useful life: the legal transaction is a commitment to make a series of periodic payments to the lessor over the life of the lease. The commercial substance is tantamount to the purchase of the machine using long-term finance. Accounting for the substance of such a transaction would mean recognising the machine as an asset in the balance sheet and the future payments as a liability. In contrast, accounting for the legal form would only see the periodic lease payments being charged as expenses in the profit and loss account - the lease would not be reflected in the balance sheet.

## 3.4. Drivers

### *3.4.1. Directives*

When the Accounting Directives were developed they were focused mainly on the needs of large and listed companies. Some regard was given to needs of the users of SMEs financial statements – though clearly not enough – as at the time the prevailing idea was that SMEs were not fundamentally different from large companies and should therefore follow similar financial reporting requirements.

### *3.4.2. Varied rules as a result of Member States' transposition*

Since the Directives offer options, leeway in defining company sizes or layouts, etc., the transposition by the Member States result in a very varied accounting landscape within Europe.

The analysis of the implementation of these options[41] shows clearly that many Member States do not fully apply them. Moreover, they have often chosen lower thresholds than those in the Directives when defining the size of small and medium-sized companies locally.

The table below provides an analysis of how key aspects of the Directives regarding simplification have been implemented. Key aspects include the definitions of small or medium-sized companies, and the use of key exemptions offered to the Member States such as on notes, annual report or statutory audit.

[41] See Commission survey at http://ec.europa.eu/internal_market/accounting/docs/2010-options_en.pdf

**Table 2 – Analysis of the use of main simplification options by the Member States**

| | TRANSPOSITION OF THRESHOLDS | | | NOTES | ANNUAL REPORT | | AUDIT | |
|---|---|---|---|---|---|---|---|---|
| | MEDIUM-SIZED COMPANIES Member State where medium-sized companies are not defined, or defined with much lower thresholds than the Directive | SMALL COMPANIES Member States where the thresholds are lower than half those of the Directive, or where small companies are not defined | SMALL COMPANIES Member States where the thresholds are below maximum, but higher than half those in the Directive | SMALL COMPANIES Member States which have made no or only moderate use of exemptions on notes offered by the Directive (*) | MEDIUM SIZE COMPANIES Member States requiring disclosure of the full set of notes | SMALL COMPANIES Member States where there is no exemption to prepare an annual report | SMALL COMPANIES Member States where an audit is required for any small company | SMALL COMPANIES Member States where an audit is required only for certain types of companies (i.e. public limited, non micro) |
| AT Austria | | | | | | | | ▲ |
| BE Belgium | ▲ | | ▲ | | | | | |
| BG Bulgaria | ▲ | ▲ | | | | | | |
| CY Cyprus | | | ▲ | ▲ | ▲ | ▲ | ▲ | |
| CZ Czech Republic | ▲ | ▲ | | ▲ | | | | |
| DE Germany | | | | | | | | |
| DK Denmark | | | | | | | ▲(**) | ▲ |
| EE Estonia | ▲ | ▲ | | ▲ | ▲ | ▲ | ▲(**) | |
| EL Greece | ▲ | | ▲ | ▲ | | ▲ | | ▲ |
| ES Spain | | | ▲ | ▲ | | | | |
| FI Finland | ▲ | | ▲ | ▲ | | | ▲ (**) | |
| FR France | ▲ | ▲ | | ▲ | | ▲ | | ▲ |
| HU Hungary | ▲ | ▲ | | | | | ▲(**) | |
| IE Ireland | | | ▲ | ▲ | | ▲ | | |
| IT Italy | ▲ | | | | | | | |
| LT Lithuania | ▲ | ▲ | | | ▲ | | | |
| LU Luxemburg | | | | | | | | |
| LV Latvia | ▲ | ▲ | | | | ▲ | | |
| MT Malta | | | ▲ | | | | ▲(**) | |
| NL Netherlands | | | | | | | | |
| PL Poland | ▲ | ▲ | | ▲ | ▲ | ▲ | | ▲ |
| PT Portugal | ▲ | ▲ | | | ▲ | ▲ | | ▲ |
| RO Romania | ▲ | | ▲ | ▲ | ▲ | ▲ | | |
| SE Sweden | ▲ | | ▲ | ▲ | | ▲ | ▲ (**) | |
| SK Slovakia | ▲ | ▲ | | ▲ | ▲ | | | ▲ |
| SL Slovenia | | | | | ▲ | ▲ | | |
| UK United Kingdom | | | | | | ▲ | | |

*Source: survey on Member States published by the European Commission in 2011* ▲: policy tends to increase burden

(*) Member States which have made use of less than half of the exemptions offered on notes by Article 44 of Directive 78/660/EC
(**) whereas an audit is required for small companies, micro-companies are exempted based on thresholds locally defined

Asked about the reasons for not making full use of the options available in the Accounting Directives, Member States put forward the differences in economic, cultural, accounting traditions, the varied legal systems, as well as the influence of taxation and statistical systems. It is pointed out that the financial statements may serve different purposes in Member States, which explains why some options are not used. Many countries apply lower thresholds levels as they consider the Directive's maximum levels are too high for their economies[42].

### *3.4.3. 'Gold plating'*

The term 'Gold plating' describes requirements imposed on companies by the Member States beyond the requirements imposed by EU legislation, as defined in section 3.1. Not using an option offered by the Directives should not be regarded as 'gold plating'. 'Gold plating' in the area of accounting is estimated to give rise to 1.6% of the total administrative burden faced by companies in the EU[43].

### *3.4.4. Other local reporting requirements*

EU limited liability companies also face other local financial reporting requirements in addition to those stemming from the Accounting Directives, such as tax and

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42 Consultation of 2009 on the Review of the Accounting Directive, p8.
43 See Consortium, 2009, p 324-328.

statistical reporting. This has been flagged by respondents to public consultations as a source of considerable burden on companies.

In a recent Commission survey, 17 Member States stated that in their jurisdiction tax valuation and measurement rules cannot be fully used in company financial statements, or vice versa. This means that companies have to prepare additional statements, or reconciliation statements in addition to their financial statements to satisfy the information needs of tax or other authorities. Indeed, 9 Member States require customized reports for tax purposes. Tax laws sometimes use recognition and valuation methods that are different from those used in general purpose financial statements. For example, Member States often allow for accelerated depreciation of certain assets in taxation in order to promote investment. Timing differences on the recognition of certain types of income and expenditure can also give rise to deferred tax assets and liabilities in the financial statements.

In 11 Member States, special statements need to be sent to the statistical authorities and in 9 Member States there are also other governmental institutions that can demand specific reports from companies.

Many respondents to the Commission consultations called for a "one-stop-shop" reporting environment where one set of financial statements could satisfy all the reporting needs of especially micro-entities, but also small companies. While the review of the Accounting Directives can facilitate the creation of a single reporting environment this can only be actually established at Member State level due mainly to differences in reporting requirements coming from other fields of non-harmonised legislation (such as tax).

### 3.5. Impact of the micro economic problems on the macro level

The problems discussed above may have an impact not only at a micro economic but also on a macro economic level. Companies, in particular SMEs, have indicated that the increased complexity and the widening scope of accounting requirements have led to extensive costs and/or use of resources.

Unnecessary and disproportionate administrative burden imposed on small companies obviously hamper economic activity. This is especially true for start-up businesses and small enterprises with limited administrative and financial resources which are sensitive to excessive administrative obligations. This results in a lower number of start-ups and less economic activity in the EU.

High levels of administrative burden can be an impediment to growth and increased levels of employment in existing companies. Resources consumed by administrative work are resources diverted away from the core business, especially for small companies. Disincentives to growth means unutilized economic potential within the EU in terms of job creation, innovation and it also means competitive disadvantage vis-à-vis third countries.

Differing accounting regulations pose a barrier to cross-border activity. For a company, to have subsidiaries in different Member States, it must be able to deal with different accounting regimes and reconcile the figures calculated on different bases to produce meaningful consolidated financial information.

For investors, a lack of comparability in financial reporting makes cross-border investments more difficult and risky. As a result, the allocation of capital in the EU is potentially sub-optimal and the full potential of a single market may not be exploited.

### 3.6. How large is the problem?

According to the latest available data there are around 7.3 million companies within the scope of the 4th Directive on annual financial statements and around 150,000 within the scope of the 7th Directive on consolidated financial statements. There are also around 7,400 companies that follow IFRS.

**Table 3 - Number of companies in the scope of the 4th and 7th Directive and the IAS Regulation**

| Directive | Micro | Small | Medium-sized | Large | Total |
|---|---|---|---|---|---|
| 4th Directive on Annual Financial statements* | 5,936,774 | 1,117,214 | 245,431 | 45,301 | 7,344,720 |
| 7th Directive on Consolidated financial statements** | 86,748 | 33,657 | 12,365 | 14,095 | 146,865 |
| IAS Regulation | ~150**** | ≤ 1,100**** | | ≥ 6,115**** | 7,365*** |

*Source:*

* *CSES 2010*

** *Consortium 2009*

*** *European Commission. 2008. Report from the Commission to the Council and the European Parliament on the operation of Regulation (EC) No 1606/2002 of 19 July 2002 on the application of international accounting standards. p. 5'*

**** *Commission estimation based on EC.2008 (number of companies) and ICAEW 2007[44] p. 35 (turnover data)*

All these companies face administrative burden as a result of obligations imposed by the Accounting Directives. The information required for the preparation of a small / medium-sized company's balance sheet and profit and loss account can, to a large extent, be taken directly from the in-house accounting system. The notes, which often require professional accountant's involvement, need more time to produce and constitute a major cost element, representing around 50% of the cost of preparing financial statements for micro and small companies and 30% for medium and large companies[45].

Any company would incur some of these costs anyhow, for internal use or to provide the necesary information to its shareholders, business partners and other interested parties on its financial performance and position: these are Business As Usual costs ("BAU"). Costs incurred only because of a legal obligation to provide information (without real business need to provide that information) constitute administrative burden. As presented in the table below administrative burden as a percentage of

44 See http://ec.europa.eu/internal_market/accounting/docs/studies/2007-eu_implementation_of_ifrs.pdf
45 See CSES study, p. 39

total administrative cost is highest for smaller companies. The numbers below relate to cost incurred in addition to the regular bookkeeping cost.

**Table 4 - Annual administrative cost and burden per company from the Accounting Directives**

| Directive | Micro | Small | Medium-sized | Large | Average |
|---|---|---|---|---|---|
| Administrative cost (€/company) | 1,558 | 2,799 | 16,660 | 61,878 | 2,756 |
| Administrative burden (€/company) | 1,169 | 1,555 | 4,290 | 0 | 1,363 |
| Administrative burden (% of administrative costs) | 75% | 56% | 26% | - | 49% |

Note: regular bookkeeping costs are not included

*Source: Consortium 2009*

As shown in the table below, the estimated total cost related to the requirements coming from the Accounting Directives stands at €19.4bn annually, half of which constitutes an administrative burden. Around 65% of the total costs and 90% of the total burden are incurred by micro and small companies.

**Table 5 - Total annual administrative cost and burden from the Accounting Directives (€bn)**

| Directive | Micro | Small | Medium-sized | Large | Total* |
|---|---|---|---|---|---|
| Administrative cost (€bn) | 9.3 | 3.1 | 4.1 | 2.8 | 19.4 |
| Administrative burden (€bn) | 6.9 | 1.7 | 1.1 | 0.0 | 9.8 |
| *Administrative burden (% total)* | *71%* | *18%* | *11%* | - | *100%* |

Note: regular bookkeeping costs are not included

* Total contains additional cost/burden of €0.09bn that could not be split into segments

*Source: Consortium 2009 (cost/burden per company), CSES 2010 (population)*

The proposal for a Directive in 2009 on micro-entities[46] already strives to ease the burden on micro-companies. The main focus should now be on small, medium-sized and large entities.

46 Proposal for a Directive of the European Parliament and of the Council amending Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities, COM/2009/0083

## 3.7. Subsidiarity and proportionality

Financial reporting in the EU has been regulated by the Accounting Directives for the last 30 years. As seen above, many of the problems we describe find their origin in the Accounting Directives and their transposition at Member State level.

According to the subsidiarity principle the EU should act only where it can provide better results than intervention at Member State level. In addition, the preferred options identified in this document should be limited to what is necessary in order to attain the objectives laid down in Section 4, and comply with the principle of proportionality, including where maximum harmonisation is envisaged.

It seems that due to their increased level of cross-border activity and relatively low number of stakeholders, small companies would need basic EU level requirements, however less burdensome than under the current Directives. In order to ensure that small companies in the EU do benefit from simplified regimes under a "think small first" approach, there is a need to ensure that companies of similar sizes are treated equally across the EU, and that Member States do not require more than necessary i.e. "gold plate". This can be best achieved through EU law, whilst any necessary latitude can be given to the Member States within pre-defined limits. Regarding medium-sized and large companies, financial reporting needs to be further harmonized and made more comparable at EU level as their activities and stakeholders are more often EU wide. EU instruments appear to be more suitable in achieving such a goal than individual action by the Member States. However Member States should have a degree of leeway to add to EU requirements for this type of company.

**Table 6 - Desired level of regulation by company size**

| | **Small** | **Medium-sized** | **Large** |
|---|---|---|---|
| external stakeholders | few | many | many |
| Cross-border activity | limited | Moderate / active | active |
| | ⇩ | ⇩ | ⇩ |
| EU level regulation | basic | minimum harmonisation | minimum harmonisation |
| Member State level regulation | limited | moderate | advanced |

*Source: Commission Services analysis*

# 4. OBJECTIVES

In line with the overarching objective of improving the business environment for EU companies, the review of the Accounting Directives aims at (1) reducing the administrative burden on companies that are relatively small in size to free up resources for growth and employment creation; (2) increasing the effectiveness, relevance and understandability of financial reporting; and (3) protecting the needs of users. The improvements should facilitate the functioning of the EU Single Market by encouraging cross-border business activities.

In order to achieve the three specific objectives listed above, the review intends to:

- Simplify and eliminate burdensome requirements for small companies. Many requirements are not particularly necessary for the users of the financial statements of these companies or do not meet the cost / benefit test;

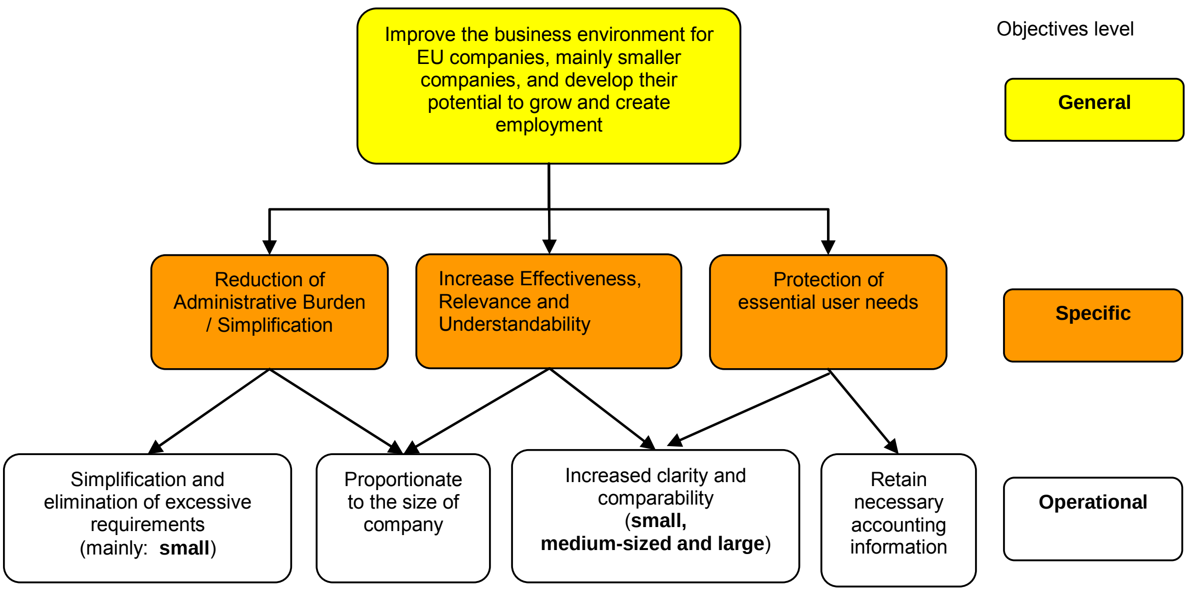
- Make requirements proportionate to the size of the company. In practical terms, in the context of the review, an 'additive' approach should be implemented (starting with the requirements for small companies, then adding requirements for medium and large companies) rather than the currently applied 'subtractive' approach (starting with the requirements of large companies then eliminating requirements for medium-sized and small companies);

- Increase the clarity and comparability of financial statements. The current level of complexity is partly the result of a very high number of Member State options in the Directives;

- Maintain the information value of financial statements so that they remain useful to users.

The hierarchy of objectives is summarised in the chart below:

*Fig. 3 – Overview of objectives*




*Source: Commission Services analysis*

## 5. POLICY OPTIONS

In order to meet the objectives set out in Section 4 the Commission services have identified and considered a number of policy options.

The financial information needs of different users may vary significantly and there is no single solution to all information needs i.e. no "one size fits all". Moreover, the limited administrative resources of small and medium-sized companies cannot accommodate all the needs of potential users. Deciding on the most relevant information needs and defining to what extent they should be served is therefore always a matter of policy judgement. Especially in the case of small and medium-sized companies, a balance needs to be struck on how to sufficiently serve the most relevant needs of users and at the same time efficiently use the limited resources (i.e. reduce the administrative burden) of these companies.

Proposals examined in this section should be seen as complementary to the 2009 proposal concerning micro-entities.

The possible policy options are discussed in detail in two sub-chapters below which consider, first, the **broad policy options** and the choice of **legal instrument** to be used (section 5.1.) and, second, a choice of **specific policy options** in the context of the review of the Accounting Directives (section 5.2.). Nine specific policy options are examined in a comprehensive way in Annex 6.

## 5.1. Broad policy options

### *5.1.1. No change to the requirements of the Accounting Directives (baseline scenario)*

In the baseline scenario no action would be taken and all EU limited liability companies would continue to follow unchanged accounting rules based on the Directives with the exception of micro entities. For this category of companies the Commission published on 26 February 2009 a proposal for exemption from the scope of the Fourth Directive. The negotiation of this proposal by the co-legislators was still ongoing at the time of drafting this Impact Assessment.

Consultations have revealed that many stakeholders seem to be broadly content with the current framework which has, on the whole, functioned well over the years. However they do see room for simplification, especially to benefit the smallest companies. A public consultation carried out in 2009[47] showed that users and public authorities seemed most satisfied with the current rules, whilst preparers were the most dissatisfied.

From discussions with Member States it is clear that some Member States do not see a need for fundamental changes to the Accounting Directives. They are satisfied with the current system while others have recently modernised their own accounting rulebook. For instance, in 2009, Germany introduced a new accounting law (BilMoG) that reduced the number of options and provided additional simplification for small companies compared to the previous framework[48]. Other countries have all

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47 See Summary report on the responses received to the Consultation paper on the review of the Accounting Directives, p.7, available at http://ec.europa.eu/internal_market/accounting/docs/200910_accounting_review_consultation_report_en.pdf

48 On overview of the main changes introduced by the German Accounting Law Modernization Act (BilMoG) approved by the German parliament on 26 March 2009 is available at http://www.ey.com/Publication/vwLUAssets/Broschuere_BilMoG_englisch/$FILE/Broschuere_BilMoG_englisch.pdf. Full text is available at

but reached the limits of simplification possible under the current Directives. For example, the Danish accounting law introduced back in 2001 created a building block model that focuses on small businesses[49]. The UK FRSSE is also an example of modern accounting designed for small companies, and has been in force since 1997[50]. The 2009 Commission consultation has also highlighted that the relative stability of EU accounting law is seen as an advantage.

However, there are flaws of the current regime, as presented in Chapter 3 above, which the baseline scenario will not address effectively. First of all, the current administrative costs stemming from the Directives for European companies are around €19.4bn annually. Half of this amount is a burden that impinges primarily on the smallest companies. It is not expected that market and national regulatory developments would achieve a substantial decrease in administrative burden without a change. The proposal for a Directive of 2009 already strives to ease the administrative burden on micro-companies. There has been so far no proposal regarding small companies, whereas they incur 18% of the burden.

The discrepancy between preparers' and users' needs would remain together with the resulting administrative burden. This option would not make improvements to the clarity of the Accounting Directives, nor the comparability of financial statements prepared following national laws based on the Directives.

The smallest companies in the EU would continue to needlessly spend resources complying with some excessive reporting requirements. Furthermore, all companies within the scope of the Directives would still be obliged to comply with some less pertinent requirements stemming partly from EU requirements and partly from requirements added by the Member States. At present there are around 120 significant Member State options in the Directives that hamper the intra-EU comparability of financial statements – these would remain.

For an analysis of how effectively this option may achieve the objectives and how it compares with the other options, please refer to the table in section 5.1.6.

### 5.1.2. *Better use of existing options in the Accounting Directives by Member States*

Not all possible reductions of administrative burden would require changes to the Accounting Directives. Even if no legislative changes were made, the Commission could nevertheless call on Member States to utilise all the simplification options already available in the Directives. Many options target small and medium-sized companies and could in theory produce burden reduction in those Member States which have not fully made use of them[51].

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http://www.bgbl.de/Xaver/start.xav?startbk=Bundesanzeiger_BGBl&bk=Bundesanzeiger_BGBl&start=//*%5B@attr_id=%27bgbl109s1102.pdf%27%5D

49 See http://www.eogs.dk/graphics/Regnskab/Regnskabslov_en.html

50 See http://www.frc.org.uk/asb/technical/frsse.cfm

51 A recent analysis in Sweden shows, for instance, that a full use of all options and threshold levels would reduce the administrative burden by 20%, see SOU,2008, Enklare redovisning. SOU 2008:67, p.176, available at http://www.regeringen.se/content/1/c6/10/76/85/4f21026a.pdf

A recent Commission survey[52] on the use of the options in the Accounting Directives by the Member States reveals that:

- All options are used at least once, but each Member State uses a different set of options;
- The thresholds for exempting small and/or medium-sized companies from certain requirements may not always be transposed. When transposed, they are often set by the Member States at a lower level than that possible under the Directives[53].

A wider use of the existing options in the Accounting Directives could be encouraged via a range of policy tools. Encouraging the use of current options by a non-binding instrument would avoid the time delay associated with the normal legislative procedure. However, there is no guarantee when, if ever, any recommendations would have effect on the accounting requirements set by the Member States, as Member States could simply ignore such recommendations.

At the same time, it must be noted that the characteristics of national economies, as well as the accounting and business cultures are different. The 2009 Consultation also identified that reasons for not taking advantage of options include differences in economies, culture, accounting traditions and legal systems, as well as the influence of taxation and statistical systems[54]. The options in the Directive were introduced precisely because there were different accounting legacies in Member States, and the Fourth Directive was one of the longest to negotiate. Without changes to the Directives, it may be very difficult to convince Member States to give up their options and pursue a standardised approach towards the use of all options and maximum threshold levels. The estimate by a consultant of the potential savings from the full use of permitted thresholds and exemptions amount to at least €0.7bn for small to large companies (See Annex 5).

In addition to the requirements of the Accounting Directives, Member States can impose national rules ("gold plating") that further increases the burden on the smallest companies. These additional requirements are estimated to amount to a further €0.3bn of burden per year for all companies. For an analysis of how this option compares with the objectives and the other options please refer to the table in section 5.1.6.

### 5.1.3. *Revision and modernisation of selected requirements currently in the Accounting Directives*

This approach would recognise the fact that the Directives have served as a solid foundation for financial reporting rules in the EU for three decades. At the same time, it would provide an opportunity to revisit the relevance of certain sections,

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52 See Commission survey at http://ec.europa.eu/internal_market/accounting/docs/2010-options_en.pdf

53 Medium-sized companies: maximum allowed levels are transposed by only 9 Member States and 14 Member States do not use the exemption for medium-sized companies at all; small companies: maximum allowed levels are transposed by only 8 Member States and 2 Member States do not use the exemption for small companies at all.

54 Summary Report of 2009 on the responses received to the Consultation paper on the review of the Accounting Directives, p8

based on recommendations from stakeholders. Notably, the current requirements could be reconsidered in terms of company size (proportionality) based on the needs of users.

Stakeholders have commended the partial harmonisation in financial reporting brought about in the EU by the Directives. At the same time, they broadly agree that a degree of simplification is necessary, especially for small companies. A "bottom-up" approach was also broadly supported in the 2009 public consultation. Support was highest amongst preparers, accountants and auditors (around 85%) and was above 60% in all other groups[55].

The opinion of banks as a major source of financing is particularly important. This stakeholder group requires a significant amount of information from companies and it has the power to ask for additional information to what is made available publicly. The CSES study[56] reveals that of the external stakeholders of companies, banks are the most likely to require more information in addition to what is contained in statutory accounts. In general terms, the banks and national banking associations interviewed for the study were of the opinion that the Directives have worked well for the last 30 years – they could be completed and modernised but not simplified.

In the same study, the accounting associations and accounting firms interviewed are of the view that many of the requirements in reporting are driven by tax or statistical authorities and it is likely that much of the information will be collected anyway. Accounting associations surveyed in the context of the study are, however, supportive of simplification and modernisation as long as the value of the financial information provided is not reduced.

In the context of a partial revision, the requirements for small companies could be reconsidered with a view to relaxing some of them to achieve administrative burden reduction.

This option would provide a possibility to strike a better balance between general principles and detailed provisions. The general underlying principles could be included in a dedicated section in the Directive. Additional principles, such as "materiality" and "substance over form", could be added[57]. Lesser used Member State options could be removed in order to obtain a shorter, more comparable and simpler EU accounting framework. One example could be a reduction in the number of layouts for the balance sheet and the profit and loss account.

The downside to this approach compared with the previous options is that it would take some time to negotiate (via the ordinary legislative procedure) and that the outcome of these negotiations would be uncertain.

The estimated potential for annual savings from this partial revision option is €1.7bn. This excludes the impact the proposal for a Directive of 2009 may have on micro

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55 Ibid., p. 6 of the Summary Report

56 See footnote 20

57 “Substance over form” and “materiality” were the most commonly cited principles by respondents to a public consultation – See Summary Report on the Responses Received to the Consultation Paper on the Review of the Accounting Directives, 2009, p6.

companies. There would be one-off transition costs arising mainly from changes to layouts and disclosure requirements. These transition costs would, in our estimation, be shared among the firms concerned, software developers and accounting professionals. How exactly they are shared would depend on the environment in which the company operates. Based on estimations in the CSES study the Commission Services conclude that the one-off transition costs could not exceed a single year's savings[58] and in all likelihood they would in reality chip off only a fraction of the first year's savings. It is also possible that the one-off transition costs arising from the update of EU legislation in the field of accounting would be bundled with more general needs for professional training and software update.

For an analysis of how this option compares with the objectives and the other options please refer to the table in section 5.1.6.

### *5.1.4. Create a wholly new EU accounting framework and adopt the "International Financial Reporting Standards for SMEs" for mandatory use within the EU*

Another option would be to implement the IFRS for SMEs (see Annex 3) at a European level for all companies except micros. This would allow replacing the current Accounting Directives by a less extensive legislative framework. Some form of approval mechanism and endorsement procedure would need to be established at EU level, possibly similar to the one currently used for the endorsement of IFRS.

With regard to the benefits of using the IFRS for SMEs, many respondents to the 2009 public consultation[59] commented that its use would allow intra European and international comparison of financial statements, and that could lead *inter alia* to easier access to finance, reductions in the cost of capital, increased trade, and increased levels of cross-border merger and acquisition activity. International groups that would be eligible to use it could see compliance costs fall and an increase in information usefulness from dispensing with different local reporting regimes. There have been mixed reactions to the IFRS for SMEs among the Member States'

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58 The CSES study quantified one-off set-up costs arising from the need to change systems for the simplification of accounts layout and to make other changes to implement some new disclosure requirements. There is not always an exact correspondence between the measures proposed in the study and the proposal presented in this impact assessment. However, where there is a slight mismatch, one can use the study as a proxy to assess the impact on transition costs of the main options examined in the present document. To give an idea about the relationship between the set-up costs and the first year's annually savings in the study, a small company would save EUR 738.9 on the simplification of layout and alleviating disclosure requirements as described in the study while it would spend on a one-off basis EUR 448.9 on setting up these changes (this is 61% of its first year savings).

59 A consultation on IFRS for SMEs carried out in 2009 shows that respondents from 13 Member States would generally favour a widespread use of IFRS for SMEs in the EU, whilst respondents from 9 other Member States would not. Supporters argued that the Standard is best suited for Large and Medium-sized companies, for international groups and subsidiaries of companies reporting under full IFRS as well as for companies active internationally, listed on non-regulated markets, seeking foreign financing or "non publicly accountable" (as defined in the IFRS for SMEs) due to enhanced ability to invest and trade cross borders. Opponents stressed the complexity of the Standard, and underlined the cost of changing accounting rules. See web page: http://ec.europa.eu/internal_market/consultations/2009/ifrs_for_sme_en.htm. A summary report of the public consultation is available at http://ec.europa.eu/internal_market/accounting/docs/ifrs/2010-05-31_ifrs_sme_consultation_summary_en.pdf. Full text of the minutes of a subsequent stakeholders event is also available at http://ec.europa.eu/internal_market/accounting/docs/ifrs/2010-05-25-ifrs-sme%20meeting_minutes_en.pdf

authorities but several of them are entirely against its endorsement for use in the EU, especially those that have recently reformed their domestic legislation or have a close link between taxation and accounting.

Others opined that the IFRS for SMEs would be too complex and costly for small businesses, whist being too simple for the largest businesses eligible to use it. The cost of changing accounting systems and re-training staff was also raised as an issue. In countries where there is presently close alignment of tax and accounting some were concerned that adopting the IFRS for SMEs could increase compliance burdens rather than reduce them. For enterprises that are active only locally it was pointed out that there is little need for the international comparability that the IFRS for SMEs could bring.

The table below provides an overview of the estimated implementation costs of introducing the IFRS for SMEs as a European accounting standard. The estimates come from a study recently completed by CSES. Introducing IFRS for SMEs for all companies except micro-companies would induce additional costs in the region of €0.16bn.

**Table 7 - Additional cost due to introduction of IFRS for SMEs**

| | **Small (excluding micros)** | **Medium-sized** | **Large** | **Total** |
|---|---|---|---|---|
| Annual additional cost per company (€) | 116 | 97 | 145 | n/a |
| Set up cost per company (€) | 147 | 228 | 166 | n/a |
| Total additional annual cost for entire population (€ million) | 130m | 24m | 6m | 160m |

*Source: CSES 2010*

The main advantage of introducing the Standard would be the creation of a harmonised system of financial reporting. This was also the main advantage of introducing IFRS for the consolidated financial statements of listed companies in 2005. Introducing the IFRS for SMEs would certainly address the objectives of clarity and comparability, whilst maintaining the necessary information value of financial statements.

However, it would not serve the objectives of simplification and reduction of administrative burden as seen above. Furthermore, the IFRS for SMEs is a new standard (released in July 2009) and its implementation worldwide is still going on and to be assessed. The opinion of stakeholders towards the IFRS for SMEs is also mixed with, as said above, many public authorities in the EU strongly opposed to it. Overall, we can conclude that there is no sufficient support nor evidence for introducing the IFRS for SMEs at EU level as an alternative to the Accounting Directives.

It does seem likely that certain Member States will adopt the IFRS for SMEs, in an amended form due to inconsistencies between the requirements of the Directives and the Standard, insofar the Directives and the IFRS for SMEs would be inconsistent (current inconsistencies are listed in Annex 3). However the requirements of the Directive would still have to be followed.

For an analysis of how effectively this option may achieve the objectives and how it compares with the other options, please refer to the table in section 5.1.6.

*5.1.5. Repeal the Directives and let the Member States put in place whatever basic accounting regime they choose for unlisted companies*

In this scenario, no administrative burden would be placed on companies at the EU level as there would be no EU-wide financial reporting requirements. This scenario would theoretically reduce the compliance costs stemming from EU legislation for companies down to zero.

However, the *raison d'être* for the Accounting Directives is to establish the requirement for limited liability companies to prepare financial statements and set minimum requirements in order to improve the EU-wide comparability of financial statements. This, in turn, should lead to a better functioning of the Single Market and, more concretely, to an increased confidence in financial statements and reports, to better access to finance, reductions in the cost of capital and increased levels of cross-border trade, merger and acquisition activity. Medium-sized and large companies have more external stakeholders and cross-border activities, hence the benefits described above are more pronounced in their case.

This option would allow in theory to reduce the burden down to a minimum, as the Member States would be given full latitude to achieve this. As a result, the potential for administrative burden reduction amounts in theory to the total burden identified in Table 5, i.e. € 9.8 bn including micro-companies, or €2.8bn excluding micro-companies. The discussions with Member States and the experience as regards the use of the current simplification options has shown however that if the EU accounting requirements were to be abolished, a large majority of the Member States would retain the current or similar accounting requirements for limited liability companies. Consequently, the theoretical administrative burden savings would not be achieved but only replaced with similar burdens at Member State level for small to large companies. With the possibility of different Member States' requirements substituting the ones currently in the Directives, there would be less harmonisation and comparability - without a significant reduction in the overall reporting burden. Furthermore, when responding to a question in the 2009 public consultation about the future role of the Directives, all respondents were in favour of retaining these[60].

For an analysis of how effectively this option may achieve the objectives and how it compares with the other options, please refer to the table in section 5.1.6.

[60] Summary Report of 2009 on the responses received to the Consultation paper on the review of the Accounting Directives, p. 25.

### 5.1.6. *Comparison of broad policy options*

**Table 8 - Comparison of the broad policy options 1 → 5**

| Option | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small/medium/large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? | Potential impact on administrative burden (EUR)<br>"-" = lower burden<br>"+" = increased burden |
|---|---|---|---|---|---|---|
| **1. Baseline** | **0** | **0** | **0** | **0** | **N/A** | **0** |
| **2. Better use of current options** | **+** | **+** | **0** | **0** | **No** | **- €0.7bn** |
| **3. Revision of selected requirements** | **++** | **++** | **++** | **+** | **Yes** | **- €1.7bn** |
| **4.Mandatory use of IFRS for SMEs (except micro)** | **-** | **--** | **+** | **+** | **No** | **+ €0.16 bn** |
| **5. Repeal current Directives** | **?** | **?** | **--** | **-** | **No** | **- €2.8bn** |

**"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable**

*Source: Commission Services analysis.*

Having compared the five broad policy options above, the preferred option is the third one - proposing a revision of selected requirements currently in the Accounting Directives.

Now that this option has been selected one needs to consider whether a Directive is still the preferred legal instrument to achieve the objectives of the review. There would be the possibility of bringing together the Fourth Council Directive on annual financial statements and the Seventh Council Directive on consolidated financial statements into a single instrument as the basis for the EU's financial reporting framework. The revised Directive would create an opportunity to make textual improvements and to rearrange the current provisions into a more rational order. It would also provide an opportunity for maximum harmonisation to achieve specific policy objectives, where necessary.

An alternative approach could be to transform the Directives into a Regulation. The main advantage of such solution would be that a Regulation is directly applicable and does not have to be transposed into national law. On the other hand, the Member States would need some discretion at national level to tailor the financial reporting obligations to local needs. There is a very strong likelihood that the far-reaching changes that a uniform approach would require could not get the necessary support from the Member States.

On balance, the most suitable choice appears to be a revised Directive merging and repealing the existing Fourth and Seventh Council Directives.

## 5.2. Detailed options – within the context of the review of the Accounting Directive

In the context of a review of the existing Directives which is the preferred option above, the Commission services have identified and analysed policy options in Annex 6. These are listed below:

***Options with an overall reach***

(1) Harmonising the definitions of the size of companies under the Directive; and/or

(2) Increasing the company size thresholds; and/or

(3) Mandating the preparation of financial statements under an electronic format such as XBRL;

***Options with an overall reach (mutually exclusive)***

Either

(4) Harmonising and clarifying certain basic principles; and/or

(5) Reducing the number of options available to Member States;

or

(6) Developing a European Accounting Standard;

***Options specific to small companies (mutually exclusive)***

(7) Simplifying layouts or requiring only key financial data instead of a fixed balance sheet and profit and loss account structure (mainly for small companies); or

(8) Reducing the information given in notes by small companies and ensuring harmonisation across the EU ("mini-regime");

***Options specific to medium-sized / large companies***

(9) Introducing a compulsory cash flow statement for certain categories of company.

We examine further below two key options that would mainly contribute to reduce the administrative burden on companies chosen from the above.

### *5.2.1. Ease the administrative burden on small companies (by creating a "mini regime") i.e. option n° 8*

As described in Section 3 small companies currently endure a disproportionately large burden compared with larger companies. In particular, preparing notes is the most time consuming part of the process for smaller companies. A balance has to be found between the essential information needs of the users of financial statements of smaller companies, and the need to reduce the burden when preparing annual financial statements.

To this end, a "mini-regime" could be established for small companies which would restrict their financial statements to a simple profit and loss account, a simple balance sheet and a limited number of disclosures. To avoid gold-plating, the requirements would follow the principle of maximum harmonisation to which the Member States would not be allowed to add requirements at national level. Hence, micro-companies would in any event benefit from this 'mini-regime' at a minimum.

The main sources of burden reduction for small companies would be:

- A reduction in the amount of information to be disclosed in the notes to the financial statements[61] in the areas of (i) accounting policies, (ii) financial commitments, (iii) related party transactions, (iv) secured debt and (v) post balance sheet events. These notes would represent a significant lessening of the current disclosure regime and would bring substantive burden reductions for small companies. At the same time what is considered to be the key information that the stakeholders of small companies need, would be kept or even increased in some Member States;

- The abolition of the requirement to audit small company financial statements and related options to exempt;

- No requirement to prepare consolidated accounts for small groups;

- “Maximum harmonisation” of the relevant requirements.

Regarding notes, accounting experts and stakeholders see the above as the minimum information that is useful for the users of financial statements. Banks, especially, value the disclosure of guarantees and commitments.

The limitation of disclosures will reduce the burden mainly in the Member States that have made only moderate use of exemptions, as described in Section 3.4.2: Cyprus, Czech Republic, Greece, Spain, Finland, France, Ireland, Poland, Romania, Sweden and Slovakia. However a detailed analysis on the extent to which small companies are currently exempt of the above obligations (see Annex 6, Option 8) indicates that small companies would nevertheless be subject to new obligations in many Member States, especially regarding the disclosure of guarantees and commitments, related parties, and post balance sheet events. This would entail additional costs of €227m for these companies, mainly in Austria, Germany, Hungary, Ireland, Italy, Lithuania, Luxemburg, the Netherlands, Latvia, Malta, Slovakia, Slovenia, Sweden and the United Kingdom.

Regarding statutory audits, whether an audit is required or not will depend on each Member State's policies, as the proposal would not foresee full harmonisation in this area. The most significant potential impact of removing the statutory audit

[61] In occasion of the 2009 public consultation, the majority of stakeholders supported the idea of reducing the number of disclosures requested for small companies. Only 4 respondents called for keeping the current rules. See p.21 of the summary report.

requirement should be concentrated in the Member States which currently require a statutory audit for all or mostly all small companies (Cyprus, Finland and Sweden), and in the Member States where the threshold defining small companies and the audit exemptions are very low, as shown in Section 3.4.2 (Bulgaria, Czech Republic, Denmark[62], Estonia, France, Hungary[63], Lithuania, Latvia, Malta[64], Poland, Portugal, Slovakia).

From the comparison of options in Annex 6, we have determined that Option 9 would best ensure that the objectives are met, with potential high acceptability, as shown in the table below:

**Table 9 - Analysis of an option to reduce the information in notes with harmonisation for small companies**

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small / medium / large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| **Reduce the information given in notes by small companies and ensure harmonisation across the EU (mini-regime)** | **Small** | ++ | ++ | + | - | **Yes** |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

It is estimated that the potential for administrative burden reduction of this proposal would reach €1.5bn attributable to: relaxation of disclosures (€1.0bn); potential relaxation of statutory audit (€0.5bn); and relaxation of consolidation obligations (€0.04bn).

It is estimated that the above "mini regime" would also have an impact on micro-companies; as the simplifications suggested above overlap to a certain extent with the simplifications foreseen through the 2009 proposal for a Directive Overall, the burden reduction observed by micro companies will either come from the "mini regime" above, or from the 2009 proposal when the corresponding legislative texts are adopted and one or more options therein used by Member States. Assuming a Member State would not take advantage of the options offered by legislation stemming from the 2009 proposal, the "mini regime" would bring about to micro companies at least the same type of simplification as that offered to small companies through the "mini-regime". The Commission Services estimate that the "mini-

[62] In Denmark, only micro-companies with less than 12 employees, a turnover below DKK3,000,000 (≈€400,000) and/or a total balance sheet below DKK1,500,000 (≈€200,000) are exempted from audit.

[63] In Hungary, the exemption from statutory audit applies only to small companies with less than 50 employees whose net turnover do not exceed HUF100,000,000 (≈€360,000).

[64] In Malta, micro companies only – balance sheet lower than €46,587, Turnover lower than €93,175 and/or less than 2 employees – are exempted from audit.

regime" could achieve a maximum of two thirds of the savings foreseen in the impact assessment for micro-companies on the basis of the 2009 proposal, absent a "micro-regime" at Member State level.

### 5.2.2. *Increase of the thresholds for small and medium-sized companies, i.e. option n° 2*

Article 53 (2) of the Fourth Council Directive calls for a review of size thresholds in the Directive every five years. The last revision of the thresholds defining small and medium-sized companies took place in 2006[65]. In the context of the review of the Directives and in line with the objective to reduce administrative burden it is therefore time to consider an increase.

An increase of monetary thresholds by around 14%, leading to the figures below, would represent roughly the increase due to inflation from 2007 till 2012. Two out of the three criteria would have to be met for any company to fall within a particular size category (small or medium-sized):

**Table 10 - Suggested level for thresholds after a revision**

| | Small companies | Medium-sized companies |
|---|---|---|
| Balance sheet total (EUR) | ≤ € 5,000,000 | ≤ € 20,000,000 |
| Net turnover (EUR) | ≤ € 10,000,000 | ≤ € 40,000,000 |
| Average number of employees during the financial year | ≤ 50 | ≤ 250 |

*Source: Commission Services.*

The average number of employees during the financial year measured, which has worked well over the years, would not change.

**Table 11 - Analysis of an option to increase company size thresholds**

| **Option** | **Size of the companies mainly affected** | **Requirements targeted to the size of the company** | **Simplification and elimination of excessive requirements (small)** | **Clarity and comparability (small/medium/large)** | **Maintain information value of financial statements (relevance of information)** | **Preferred option (yes / no / N/A)?** |
|---|---|---|---|---|---|---|
| **Revise the thresholds** | Small, Medium, Large | ++ | ++ | **0** | - | **Yes** |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

65 Thresholds defining SMEs are available at http://ec.europa.eu/internal_market/accounting/sme_accounting/thresholds_en.htm

As a result of this threshold increase the Commission services have estimated that around 62,000 medium-sized companies would shift to the small category, resulting in a total administrative burden reduction potential of this proposal of €0.2bn. This calculation has been made under the assumption that large companies shifting to the medium-size category would benefit from only marginal savings, therefore not estimated.

The table below provides an overview of the analysis of possible options (summary from Annex 6).

**Table 12 - Overview of options under a review of the Directives**

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small / medium / large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| **1. Harmonising company size definition** | Small, Medium, Large | ++ | ++ | + | - | **Yes** |
| **2. Increasing the company size thresholds** | Small, Medium, Large | ++ | ++ | **0** | - | **Yes** |
| **3. Mandating an electronic format / XBRL** | Micro, Small, Medium, Large | **0** | **0** | ++ | + | **No** |
| **4. Harmonising and clarifying basic principles** | Small, Medium, Large | **0** | **0** | ++ | ++ | **Yes** |
| **5. Reducing the number of options available to Member States** | Small, Medium, Large | **0** | + | ++ | **0** | **Yes** |
| **6. Developing a EU accounting Standard** | Small, Medium, Large | **?** | + | ++ | **?** | **No** |
| **7. Simplified layouts or only key financial data** | Small | ++ | ++ | - | -- | **No** |
| **8. Reducing the information given in notes by small companies and harmonisation across the EU** | Small | ++ | ++ | + | - | **Yes** |
| **9. Introducing a cash flow statement** | Medium, Large | + | **N/A** | + | + | **No** |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

## 6. ANALYSIS OF IMPACTS

### 6.1. Overview of the preferred options

**Table 13 - Summary of the preferred options**

| Scope | Preferred Options |
|---|---|
| **Small Companies**<br>~ 1,1 million<br>~15 % of all companies | • Companies will have to prepare a profit and loss account and a balance sheet following the accounting principles laid down in the Directives.<br>• Limited, but fully harmonised disclosures in the notes to the financial statements.<br>• Introduction of general principles of "materiality" and "substance over form".<br>• Reduction in the number of Member State options.<br>• There would be no requirement for audit in the Directive<br>• There could be a maximum harmonisation aiming to avoid the preparation of consolidated financial statements. |
| **Micro-Companies**[66]<br>~ 5,9 million<br>~81% of all companies | • Micro companies will at least benefit from the same regime as small companies.<br>• If the proposal tabled by the Commission in February 2009 is adopted by the co-legislators then it is expected that the latter would take the form of options to depart from the regime applicable to small companies. The Member States could tailor their own "micro regime" on that basis. |
| **Medium/Large Companies**<br>~ 0.3 million<br>~ 4% | • Introduction of general principles of "materiality" and "substance over form".<br>• Reduction in the number of Member State options, resulting in a better comparability of the financial statements within this category of companies. |

*Source: Commission Services analysis.*

[66] This summary does not take into account the impacts of the proposal for a Directive on Micro-Entities tabled by the Commission in February 2009.

## 6.2. Expected primary impact of the preferred policy options

In general terms, the initiative should reduce the administrative burden of financial reporting for all companies. In line with the objectives of the review, the impact is likely to be greatest for smaller companies, as the review Directive would require them to only present and disclose the most relevant and useful information. The key needs of financial statements' users would continue to be met, but information of lesser importance, and which is burdensome to prepare would no longer be provided.

**Table 14 - Analysis of the primary impacts of the preferred options**

| | **Primary impacts of the preferred policy options** |
|---|---|
| Reduction of administrative burden. | The burden reduction potential of the review Directive amounts to EUR 1.7 bn. The main beneficiaries of the burden reduction would be small companies (around EUR 1.5 bn per year). Medium-sized companies would altogether save EUR 0.2 bn per year. The comparison of this potential with the overall burden identified in Table 5, is as follows:<br><br>(€ bn) — Small — Medium — Large<br>Overall burden — 1.7 — 1.1 — -<br>Reduction — 1.5 — 0.2 — -<br><br>This calculation does not take account of a significant level of burden reduction that would come from savings realised by micro companies as a result of the mini-regime explored in Section 5.2.1. This is because a large portion of these savings could be equally considered as being achieved through the 2009 proposal, to which the policy choices in this document are considered to be complementary, and which effects have been assessed in a separate Impact Assessment[67]. |
| Impact on the information available to external stakeholders, investors and creditor protection. | Small companies: Creditor protection would be kept or even strengthened due notably to the fact that disclosures of "Guarantees and commitments, contingencies, arrangements" and "Related party transactions" would become mandatory for this category of company.<br><br>Medium-sized and large companies: Slightly positive impact due to an improved comparability of the financial statements. |
| Impact on the single market and level playing field. | For all other categories of company the impact would be positive due especially to the maximum harmonisation of company size thresholds, a significant reduction in the number of Member State options and maximum |

67 Commission Staff Working Document Accompanying the Proposal for a Directive of the European Parliament and of the Council amending Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities - Impact assessment. SEC(2009) 206, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SEC:2009:0206:FIN:EN:PDF

| | |
|---|---|
| | harmonisation of reporting requirements for small companies. |
| Impact on collection of statistical data. | For all categories of company the maximum harmonisation of thresholds could make the collection of statistical data more difficult from small companies. In the 11 Member States where the statistical authorities require customised statements there should be no impact on the collection of statistical data. In one Member State where the statistical authorities have the power to require additional information beyond the financial statements some adjustment (cost) would be involved if the statistical offices find that some crucial financial information is missing from the less burdensome statements. In the Member States where all governmental institutions use the same financial statements, if some crucial financial information would be missing for statistical purposes, it would have to be requested from some companies separately.<br><br>At the same time, the maximum harmonisation of thresholds would allow the collection of data for companies that are objectively the same size across the EU, thereby improving comparability. |
| Impact on collection of information for taxation. | No discernible impact - tax authorities would retain the power to decide how income / profits for tax purposes should be computed and measured and what should be the associated reporting requirements. The power to carry out verifications of financial information would not be disturbed. In certain countries a modification of legislation may become necessary. |
| Impact on accountants and auditors. | Some decrease in the demand for external accountants and auditors' services due to reduced requirements, including for small accounting and audit firms. However, it is estimated that the impact of the proposal on fees and jobs at accounting firms should be limited[68]. |

[68] Overall, it is expected that a substitution of consulting on accounting issues to other services will take place. This is because when statutory audits are lifted due to new exemptions or the increase in thresholds, anecdotal evidence shows that either companies will continue to voluntarily have an audit, or they will use the savings on statutory audit to get new services from the same accounting firms. Only in a minority of cases will companies not recycle at least part of the savings with an external accountancy firm. We provide below more material to support this assertion.

Currently, the Directives require an audit for all companies, but enable the Member States to exempt small companies. Table 2 in Section 3.4.2 provide an overview per Member State. Savings of €0.5bn for small companies would follow in the first place from simpler audits along with simpler accounting regime supported by this proposal. Resources spent on the statutory audit of a small company would be reduced by around 15% as a result of this simplification (CSES 2010, p41). As for the remaining 85%, savings would depend on how the Member States will implement the policies of this proposal in terms of audit exemption, and whether the thresholds defining small companies will be harmonised in the EU as a result of the adoption of a revised Directive as contemplated in this report.

For the Member States that will exempt their small companies of an audit, surveys performed in the UK

*Source: Commission Services analysis*

## 6.3. Other impacts:

### *6.3.1. Economic Impacts*

- **SMEs** are the main focus of this initiative. They should benefit from a significant reduction in administrative burden which, in turn, should free up resources for productive purposes. Cutting "red tape" gives further encouragement to entrepreneurial citizens to start-up in business. In addition, burden reductions applicable to limited liability companies may to a certain extent also similarly relieve other types of companies in member States where the regime for the latter overlaps with the regime for limited liability companies.

- **Competitiveness, trade and investment flows**: for larger companies, fewer options lead to increased comparability of the financial statements and a better focus on information that is really useful in decision-making. This will result in better investment decisions and a better allocation of capital, thus facilitating cross-border investment, trade and competition.

- **Operating costs of business/Small and Medium Enterprises**: simplification and burden reduction is likely to lower the operating cost of EU SMEs.

- **Public authorities**: the revision will not have budgetary consequences for public authorities.

- **Third countries and international relations**: A reduction of administrative burden on the smallest companies should benefit EU small companies in terms of competitiveness vis-à-vis companies from other jurisdictions with lighter regimes (e.g. USA). In addition, better comparability and clarity of the financial statements

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(Directors' Views on Accounting and Auditing Requirements for SMEs by Dr Jill Collis, 2008 / Directors' Views on the Exemption from the Statutory Audit" Jill Collis October 2003 URN 03/1342 available at http://www.bis.gov.uk/policies/business-law/research/audit-accounting-and-reporting-research) tend to demonstrate that the impact on accounting firms would be limited. The surveys show that first, some companies will continue to voluntarily have an audit for various reasons (32% of small companies surveyed in 2006 – Collis/BERR, 2008). Second, for companies discontinuing the audit, the relationship with the external accountant or auditor will continue, as it is "apparent that amongst the companies having the accounts audited the external accountant is also the auditor” (Marriott, N., Collis, J. and Marriott, P. - 2006 - Qualitative review of the accounting and auditing needs of small and medium-sized companies and their stakeholders, http://www.frc.org.uk/documents/pagemanager/poba/Case%20studies%20report.pdf). This is even truer as the company is smaller. In France, where stricter independence rules prevent an auditor from providing non-audit services to audit clients, an auditor would be allowed to offer other services than an audit as soon as the audit firm/he/she is no longer the auditor. In the UK, "more than half of the companies whose directors had discontinued the audit since 2003 (54%) reported no difference in their total accountancy fees. The reasons for this offer scope for further investigation, but case study evidence from previous research suggests the amount saved may have been offset by a re-apportioning of the fees for accounts preparation or the provision of additional services" (Collis/BERR, 2008). Such services may be for instance to assist companies on their funding, their structure, their organization and internal control, their systems, taxes, acquisitions, etc. The external accountant may also be in a position to offer new services if and when a Member State would implement "one stop shop" solutions, as it is foreseeable that in such case, external accountants would generally be the one to assist the companies preparing electronic filings etc.

of EU companies could make the EU more attractive to foreign capital and entrepreneurs.

- **Macroeconomic environment**: the proposal is likely to contribute to economic growth by freeing firms' resources for productive use.

*6.3.2. Social Impacts*

- **Employment and labour markets**: by freeing up resources available to companies, it is expected that the initiative would contribute, at least marginally, to the creation of jobs in the EU. Simplified accounting requirements should foster a business climate that encourages company formation and entrepreneurship. Some of the savings at company level will stem from a reduction of fees paid to accountancy firms or external accountants, but the impact on accountants' jobs due to this transfer of resources is expected to be neutral or only marginally negative, as explained in section 6.2.

- **Standards and rights related to job quality**: the proposal should not significantly reduce the information that is useful to employees.

*6.3.3. Environmental Impacts*

No measurable environmental impacts are expected. Shorter financial statements would diminish printing needs.

## 7. MONITORING AND EVALUATION

The revision of the Accounting Directives represents a major initiative to reduce the administrative burden stemming from excessive accounting requirements, and to further align the accounting rules to the real needs of users and preparers. In light of the policy objectives set out in Section 4, the following arrangements are proposed in order to set up an appropriate monitoring and evaluation framework.

### 7.1. Monitoring

The Commission will monitor the implementation of the review Directive in cooperation with the Member States throughout the implementation period which is expected to last possibly until mid 2014. In compliance with the principle of subsidiarity, the relevant information should be gathered primarily by the Member States. They appear to be best positioned to do this as they shall have relevant necessary information at their disposal (data collected from national statistical authorities, social data etc.). The Accounting Regulatory Committee (ARC) could serve as effective fora for information sharing. Monitoring activities should be based on a thorough assessment of a number of indicators such as the number of companies in existence, the number of start ups, relevant changes in the number of foreign subsidiaries established in the EU Member States.

During this time, implementation workshops will also be organised by the Commission in order to share best practices and clarify questions that might arise in the course of the implementation period.

## 7.2. Evaluation

On the basis of the data collected, and three years after the expiration of the implementation deadline, the Commission will consider the need to produce an ex-post evaluation report.

The evaluation of effects and functioning of the revised Directive will include an ex-post assessment as regards the key objectives of overall reduction of administrative burden and better alignment of the accounting rules with the needs of users and preparers of the financial reports. Consideration will also be given to the quality and accessibility of relevant financial information to stakeholders. Possible indicators in this respect could include *inter alia* the analysis of actual changes experienced by small companies as a consequence of the implementation of the revised Directive and a qualitative analysis of the reporting practices of the small companies including the reports required by stakeholders, especially the providers of finance.

Such an evaluation will be carried out by the Commission services in cooperation with the Member States, on the basis of all the relevant information collected in the framework of the monitoring activities described above. Further information could also be directly gathered by the Commission by surveying members of the ARC. Consultations could be carried out via other already existing platforms such as the European Business Test Panel (EBTP)[69]. All the above listed options could allow data collection at limited cost at EU level, as they would make broad use of existing structures and would not require the setting up of new instruments. The possibility of contracting an external study on the implementation and effects of the review Directive will be considered.

The results and feedback from monitoring and evaluation will be considered with a view to propose further amendments where appropriate.

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69 See http://ec.europa.eu/yourvoice/ebtp/index_en.htm

**ANNEX 1**
**Legal environment in the EU and in the main trading partners of the EU**

The Accounting Directives, together with IAS Regulation, are the main legal instruments to form the EU aquis in accounting.

(1) Accounting Directives

In the fields of accounting and auditing, the Company Law Directives establish minimum requirements for the annual financial statements of mainly limited-liability companies (Fourth Directive)[70]and group financial statements (Seventh Directive)[71]. A separate Directive lays down the requirements for the audit of annual and consolidated financial statements[72].

The purpose of general financial statements is to inform stakeholders (investors, creditors, employees and other interested parties) about the financial position of a company. The Fourth Directive was adopted in 1978 in order to create a harmonised set of requirements for the external financial reporting of limited liability companies in the EU. In 1983, the Seventh Directive was adopted and added a common set of requirements for consolidated financial reporting.

The Fourth Directive aims at harmonising Member States' provisions concerning the presentation and content of annual financial statements and annual reports, the valuation methods used and their publication and audit in respect of companies with limited liability. The Seventh Directive harmonises national laws on consolidated financial statements.

The Accounting Directives mainly follow a principles-based approach, but also provide for detailed rules in many accounting areas. They represent "minimum harmonisation" beyond which Member States can develop additional requirements (i.e. gold plating). They currently contain around 120 significant options at Member State level, many of which are aimed at reducing the reporting requirements for small and medium-sized companies. The Directives have been amended several times, but they have not been subject to a fundamental revision since their inception.

The Accounting Directives have established, since 1978, the minimum framework for financial reporting of limited liability companies in the EU. These Directives have served as the basis for general purpose financial reporting in the European Union for about three decades. It is generally agreed that they have led to an improved financial reporting environment in the EU and that has been in the interest of preparers[73] as well as users[74].

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70 Fourth Council Directive of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies (78/660/EEC) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:01978L0660-20070101:EN:NOT

71 Seventh Council Directive of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts (83/349/EEC), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:01983L0349-20070101:EN:NOT

72 Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC (Text with EEA relevance), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:02006L0043-20080321:EN:NOT

73 Defined as company / management preparing the financial information.

74 Defined as stakeholders relying on the financial information, such as for example investors, providers of financing, employees.

The structure of the Accounting Directives dates back from 1970's, with primarily large companies in mind. Since then, the business environment, accounting practices and user needs have changed significantly.

(2) International Financial Reporting Standards (IFRS)

A fundamental change in the EU financial reporting environment took place in 2005 when International Accounting Standards (IAS/IFRS) became mandatory for listed companies and those companies with listed debt securities[75]. Consequently, the Accounting Directives were modified to accommodate the use of IFRS for listed companies. Through the adoption of the IAS Regulation N° 1606/2002 EU-listed companies have to present consolidated financial statements according to IFRS, and consequently, IFRS has become the most relevant framework for listed companies.

The International Financial Reporting Standards (IAS/IFRS) are set by the International Accounting Standards Board (IASB), which is an independent private standard setting body based in London. IFRS is a comprehensive set of financial reporting standards designed for listed companies. IFRS can be complex, given the sophisticated needs of the users of listed companies' financial statements, and is not an ideal basis for financial reporting for smaller non-listed companies. The IFRS for SMEs was developed to address the needs of smaller non-listed entities (see Annex 3 for more detail).

(3) Practices in the main trading partners of the European Union

In other economically comparable jurisdictions and key trading partners of the European Union (EU), financial reporting requirements for small companies are generally less demanding than the requirements of the Accounting Directives. The comparison is of relevance with regard to EU's relative competitiveness and the goals of the Europe 2020 strategy[76].

In the US, only companies listed on stock exchanges regulated by the U.S. Securities and Exchange Commission (SEC) are required to prepare and publish their financial statements under US Generally Accepted Accounting Principles (GAAP), with the exception of third country issuers that can also report under IFRS. For unlisted companies there is generally no legal obligation to prepare or publish financial statements. They must only prepare tax returns following the tax accounting rules, or they may choose to prepare financial statements on a voluntary basis to their stakeholders. If financial statements are prepared, companies may utilise simplifications available for private (not listed) companies, depart from some standards or follow standards other than US GAAP. It is estimated that around 30% of private companies do not release any financial information to external users.

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75 Regulation (EC) No 1606/2002 of the European parliament and of the Council of 19 July 2002 on the application of international accounting standards, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002R1606:EN:NOT

76 See http://ec.europa.eu/growthandjobs/pdf/european-dimension-200712-annual-progress-report/200712-annual-report-integrated-guidelines_en.pdf

In Japan, small incorporated companies prepare financial statements under Japanese GAAP for taxation purposes. In Canada, in addition to tax reporting, all incorporated companies must prepare financial statements for their shareholders. There are simplified options for small companies and no requirement to file them in a public register.

## ANNEX 2
## Summary of consultation activities

### (1) Informal ad-hoc SME reflection group

In the end of 2008, the Commission set up an informal ad-hoc SME Reflection Group to prepare the review of the Accounting Directives. The Reflection Group was composed of 10 qualified experts with diverse but highly relevant profiles. This group met five times between December 2008 and February 2009. The task of the Group was to reflect on the kind of issues that would be relevant in the context of the review in order to help the Commission to identify the issues relevant for the public consultation.

### (2) Public Consultation on the Review of the Accounting Directives and a stakeholders' meeting

In compliance with the better regulation principles, the Commission held from 25 February 2009 to 30 April 2009 a public consultation on the simplification of accounting rules in the scope of the Accounting Directives[77]. A stakeholders' meeting was organised on 12 June 2009 to consider the results. This Stakeholders consultation raised a number of issues relating to the modernisation and simplification of the Accounting Directives. The Commission's legal proposal is based on an analysis of the comments received on the consultation paper[78]. On the basis of responses to the Stakeholders consultation a number of preliminary ideas were rejected.

### (3) Public Consultation on the International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs) and a stakeholders' meeting

See Annex 3 for further details.

### (4) Series of targeted stakeholder consultations – meetings with stakeholders

In 2009 and 2010 the Commission services carried out a series of consultations with stakeholders including national standard setters, representatives of small and medium-sized businesses, banks, investors and accountants across EU. The objective of the consultations was to hear the views of the stakeholders on the IFRS for SMEs, on the reporting needs of SMEs and on other issues of relevance to the EU SME accounting framework.

### (5) EFRAG Working Group on SMEs

The European Financial reporting Advisory Group (EFRAG)[79] established in 2009 a Working Group on SMEs. The role of the group is to support EFRAG on issues related to the 4th and 7th directives, IFRS for SMEs and on other accounting matters related to small and medium sized companies. It also provides EFRAG with publication-ready reports etc. on selected issues.

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77 Available at http://ec.europa.eu/internal_market/consultations/2009/company_law_dir_en.htm

78 Available at http://ec.europa.eu/internal_market/accounting/docs/200910_accounting_review_consultation_report_en.pdf

79 See http://www.efrag.org/homepage.asp

The group consists of 12 members with technical expertise in financial reporting from a variety of international backgrounds. Members have been selected to ensure balanced representation of different backgrounds including preparers, auditors, academics, standard setters, credit providers and other users of financial statements from small and medium sized companies[80].

The group met several times in 2009 and 2010. The group considered a number of questions related to the revision work. In 2009 it gave its contribution on issues including the general orientation of the overhaul, user needs and problems, objectives of the revision, general and detailed comments and suggestions on proposals put forward and indications on impacts and effects on administrative burden. In 2010 the Group conducted a comprehensive analysis of differences between IFRS for SMEs[81].

**(6) Study on the effects on administrative burden from changes to Accounting Directives**

In December 2009, the Commission contracted a study with the Centre for Strategy and Evaluation Services (CSES) to provide information to assist the review of the 4th Company Law Directive in connection with its simplification and also the potential implementation of IFRS for SMEs.

In line with the preliminary proposals on the basis of the first public consultation, the first objective of this assignment was to evaluate the potential change in administrative burden associated with simplifying the balance sheet and profit and loss account layouts and requiring the preparation of a cash flow statement. Hence the study separately assessed the savings from simplification / reduction measures and also the increased costs of imposing a cash flow statement.

CSES was also asked to assess costs associated with various disclosures currently required and evaluate the potential burden reduction a reduced level of disclosures would bring.

Furthermore, CSES was asked to quantify implementation costs of the IFRS for SMEs and the annual costs of reporting according to IFRS for SMEs.

Costs associated with the changes were defined as those internal to the company such as bookkeeping time and accounting system upgrades and external costs such as professional accountant's time.

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80 For more details on the EFRAG SME Working group and list of Members, see http://www.efrag.org/wg/detail.asp?id=67

81 Full text of the EFRAG Compatibility Analysis, "IFRS for SMEs and the EU Accounting Directives", is available at http://www.efrag.org/news/detail.asp?id=548

The output[82] from the study has served as background for Commission Services work on the proposal for changes to the Directives. It has also been used as an input to this Impact Assessment.

[82] Full text of the study available at http://ec.europa.eu/internal_market/accounting/docs/studies/2010_cses_4th_company_law_directve_en.pdf

## ANNEX 3
## The International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs)

Currently IFRS[83] must be followed when preparing the consolidated financial statements of listed companies. 18 Member States permit or require the use of IFRS in preparing annual financial statements for certain types of companies, and all 27 Member States permit or require the consolidated financial statements of unlisted companies to be prepared in accordance with IFRS[84].

In July 2009 the IASB finalized the IFRS for SMEs[85]as best practice accounting reporting for unlisted companies. The IFRS for SMEs is an accounting standard designed to be used by any entity that does not have public accountability. It was published by the IASB in its final form in July 2009. It is a 230-page standard tailored to the needs and capabilities of smaller businesses. Many of the principles in IFRS for recognising and measuring assets, liabilities, income, and expenses have been simplified; topics in IFRS that are not relevant to SMEs have been omitted; and the number of required disclosures has been significantly reduced.

It is a "stand-alone" standard with the exception of one "fallback" option to IFRS; that is an option to use IAS 39[86] to recognise and measure all financial instrument transactions, but their disclosure must be in accordance with the IFRS for SMEs, not IAS 32[87] or IFRS 7[88].

*Inconsistencies with the Directives*

After an extensive analysis[89], EFRAG has concluded that there are six differences between the IFRS for SMEs and the extant Directives. These comprise the following:

(1) Disclosure of extraordinary items is prohibited by the IFRS for SMEs, and allowed by the Directives;

(2) There are different measurement criteria on certain financial instruments;

(3) For goodwill where useful life cannot be estimated, the indicative amortisation period is 10 years under IFRS for SMEs, versus 5 years under the Directives;

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83 The International Financial Reporting Standards (IFRS) are prepared by the International Accounting Standards Board and adopted in the EU following comitology procedures.

84 See http://ec.europa.eu/internal_market/accounting/docs/ias/ias-use-of-options2010_en.pdf

85 The IFRS for SMEs was designed with a hypothetical company of 50 employees in mind. Therefore it would be better suited for Medium/Large unlisted companies rather than Micro/Small companies. In accordance with this, those Member States that are interested in using it (e.g. UK) do not plan to use it for small companies

86 International Accounting Standard 39 – Financial Instruments: Recognition and Measurement

87 International Accounting Standard 32 – Financial Instruments: Presentation

88 International Financial Reporting Standard 7 – Financial Instruments: Disclosures

89 See letter to European Commission of 28 May 2010 on compatibility of the IFRS for SMEs and the EU Accounting Directives available at http://www.efrag.org/files/EFRAG%20public%20letters/IFRS%20for%20SMEs%20compatibility%20analysis/The%20Letter.pdf

(4) IFRS for SMEs require any negative goodwill to be immediately recognised in the profit and loss account, whereas under the Directives this can only happen if certain conditions are met;

(5) IFRS for SMEs require unpaid called-up capital to be presented as an offset to equity and not as an asset, whereas the Directives require unpaid called-up capital to be presented as an asset;

(6) The reversal of a goodwill impairment is prohibited by the IFRS for SMEs, whilst the Directives require a reversal whenever the reasons giving rise to the goodwill impairment have ceased to apply.

*Public Consultation conducted by the European Commission*

After its issuance in July 2009, the IFRS for SMEs was widely discussed amongst stakeholders (including Member States, accountants, auditors and preparers). The European Commission conducted a public consultation that run from November 2009 until March 2010.

Our consultations have shown that there is a clear cut divergence of views of EU companies about a possible adoption of IFRS for SMEs. Many companies support an adoption, but many others do not. For some companies, including multinationals with subsidiaries in different countries, companies that are part of a group, and companies seeking international finance, IFRS or the IFRS for SMEs are a preferred reporting standard, the latter being seen as easier standard to comply with than full IFRS. Similar conclusions are drawn from the study evaluating application of IFRS in the EU[90], which notes that SMEs have more problems with IFRS and would prefer to follow IFRS "light" if the application of IFRS was to be generalised.

Some of the respondents expressed the view that the IFRS for SMEs would allow international comparison of financial statements and that this may lead inter alia to increased access to finance, reductions in the cost of capital, increased trade, and increased levels of cross-border merger and acquisition activity. International groups that would be eligible to use it could see compliance costs fall and increased information usefulness from dispensing with different local reporting regimes.

Others commentators questioned whether the Standard was simple enough for small businesses or whether it represented an over simplification for the largest businesses eligible to use it. The cost of changing accounting systems and re-training staff was raised as an issue also, as was the effect on tax liabilities in making the transition from local GAAP to the Standard. Some commentators, especially from countries where there is presently close alignment of tax and accounting, questioned whether adopting the IFRS for SMEs would increase compliance burdens by duplicating reporting requirements as it would be less aligned to tax provisions than national accounting rules. In compliance with the better regulation principles and given the potential significance of the IFRS for SMEs for the European accounting framework, the Commission held a

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90 See Ineum. 2008. Evaluation of the Application of IFRS in the 2006 Financial Statements of EU Companies. p. 15, http://ec.europa.eu/internal_market/accounting/docs/studies/2009-report_en.pdf

public consultation on IFRS for SMEs from 17 November 2009 until 12 March 2010. The objective of the consultation was to gain an understanding of EU stakeholders' views on the Standard and its role in the European accounting framework. A stakeholders' meeting was organised on 25 May 2010 to consider the results[91].

*Summary of stakeholders' events in the Member States*

Moreover, the Commission services carried out a series of meetings with stakeholders in the course of 2009 and 2010, attending a number of events organised across the EU. A detailed list of the meetings is provided in the table below. These events saw the participation of key stakeholders including public authorities, national and international standard setters, academics, representatives of small and medium size businesses, banks, investors, preparers and accountants established in several Member States. The Commission services were consequently given the opportunity to gather their views on issues related to, *inter alia*, the IFRS for SMEs and its role in the European accounting framework, the reporting needs of SMEs as well as other general issues of relevance to the EU SME accounting framework and the revision of the Accounting Directives. The outcome of the discussions highlighted a number of arguments in favour and against the adoption of IFRS for SMEs in the EU accounting framework, as well as some more general remarks concerning the revision of the Accounting Directives.

As regards the potential benefits linked to the adoption of IFRS for SMEs, the main aspects mentioned by the stakeholders included: greater international comparability (especially in case of international subsidiaries); easier access to finance; easier consolidations for groups operating cross-border; smoother transitions to different frameworks where companies grow or become listed; enhanced efficiency in management, competitiveness and allocation of capital.

However, some potential drawbacks were also identified. In particular, some stakeholders stated that international comparability would not be a significant issue for all SMEs, since only some of them are internationally active; IFRS for SMEs might constitute an additional administrative burden for the smallest companies not necessarily enhancing the quality of the information provided; the prohibition on capitalisation of interest and development costs may have material effects on some balance sheets; accountants without knowledge of IFRS may find it difficult to deal with the standard; and more time and studies would be needed to properly assess its applicability.

Further general remarks concerning the revision of the Accounting Directives included the need to bring legislation in line with international developments in order to meet new standards of transparency and relevance; the need for further reflection on the scope of application and on some specific definitions (i.e. public accountability); the need for increased cooperation between different authorities (tax, accounting, statistics, etc); the inclusion of cash flow statements, which was widely supported especially for large companies; and the creation of a potential EU-wide electronic publication platform.

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91 For complete results of the public consultation, see http://ec.europa.eu/internal_market/accounting/docs/ifrs/2010-05-31_ifrs_sme_consultation_summary_en.pdf. Full text of the minutes of the stakeholders event is also available at http://ec.europa.eu/internal_market/accounting/docs/ifrs/2010-05-25-ifrs-sme%20meeting_minutes_en.pdf

Wide support was also expressed for the think small first principle and for the bottom-up approach. With regards to possible implementation, a number of different views were expressed such as granting a "company" option, a "Member State" option, and a potential exemption for micro companies, a tier-based approach, or a 2-3 years' phase-in period.

**Meetings held by the European Commission with stakeholders on IFRS for SMEs**

| Date | Member State/country/city | Organiser |
|---|---|---|
| 7 – 8.10.2009 | Geneva, Switzerland | UNCTAD/ISAR – United Nations Conference on Trade and Development – Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting |
| 20.10.2009 | Brussels, Belgium | UEAPME - European Association of Craft, Small and Medium-sized Enterprises |
| 26.11.2009 | London, UK | ICAEW - Institute of Chartered Accountants in England and Wales |
| 01.12.2009 | Frankfurt, Germany | DRSC - Accounting Standards Committee of Germany |
| 9.12.2009 | Dublin, Ireland | ICAI - Chartered Accountants Ireland |
| 9.12.2009 | Bucharest, Romania | ACCA - Association of Chartered Certified Accountants |
| 10.12.2009 | Prague, Czech Republic | ACCA - Association of Chartered Certified Accountants |
| 10.12.2009 | Rome, Italy | OIC - Italian National Standard Setter |
| 17.12.2009 | Brussels, Belgium | Regional Representation of Basse-Normandie to the EU |
| 12.1.2010 | Brussels, Belgium | ACCA - Association of Chartered Certified Accountants |
| 25.02.2010 | Riga, Latvia | EU Representation |
| 5.3.2010 | Lisbon, Portugal | EU Representation |
| 12.3.2010 | Warsaw, Poland | EU Representation |
| 15.03.2010 | Finland, Helsinki | EU Representation |

# ANNEX 4
## Problems differ across different company sizes

The ownership of companies, as well as the users of financial statements differ significantly according to the size of companies. We explain below on this basis why it appears relevant to differentiate the approach between micro/small companies on the one hand, and medium-sized/large on the other.

### *Ownership structure*

About 30% of companies under the Accounting Directives are owner-managed companies[92]. This information is also corroborated by Eurobarometer[93] data:

**Ownership structure of EU enterprises (all legal forms)**

| Type of ownership | Micro | Small | Medium-sized | Large | All sizes |
|---|---|---|---|---|---|
| Shareholders - company is listed on a stock market[94] | 5% | 11% | 16% | 27% | 6% |
| Family or entrepreneurs (more than one owner) | 44% | 52% | 48% | 33% | 45% |
| One owner | 40% | 22% | 11% | 6% | 38% |
| Other firms or business associates | 9% | 14% | 18% | 27% | 10% |
| Venture capital firms or business angels | 1% | 1% | 4% | 3% | 1% |

*Source: Eurobarometer. 2009. Access to finance. Annex p.28[95]; Commission own calculations*

Around 85% of micro companies and 75% of small companies are owned either by a single entrepreneur, or a family or small group of owners. In the case of medium-sized and large companies there is a significant decrease in single-owner companies and an increase in the spread of shareholdings. In all size groups the majority of shareholders have direct access to financial information (single owners, family and entrepreneurs, other firms, venture capital firms).

At the other end of the spectrum are large companies that issue shares to the general public. An individual investor in such a company usually has no powers to obtain information available to management and must rely on the public financial statements. Investors need information upon which to judge the performance of the company and its management.

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92 CSES 2008, p. 16 - http://ec.europa.eu/internal_market/accounting/docs/studies/micro_entity_en.pdf

93 Eurobarometer. 2009. Access to finance. Annex p.28, Report available at http://ec.europa.eu/enterprise/policies/finance/files/survey_access_to_finance_analytical_report_en.pdf. Annex 1available at http://ec.europa.eu/enterprise/policies/finance/files/survey_access_to_finance_annex_part_a_en.pdf Annex 2 available at http://ec.europa.eu/enterprise/policies/finance/files/survey_access_to_finance_annex__part_b_en.pdf

94 Most SMEs in this caption are not necessarily listed on a regulated market, and most of those which are listed in a regulated market have no subsidiaries and hence do not prepare consolidated accounts. As a result, most SMEs in this caption are not subject to the IAS Regulation (EC) No 1606/2002 of the European Parliament and the Council.

95 http://ec.europa.eu/public_opinion/flash/fl_271_annex_en.pdf

Looking at the Eurobarometer data above, a clear correlation between size and dispersed shareholding emerges - the number of micro and small companies with dispersed shareholdings is 5% and 11%, growing to 16% and 27% for medium-sized and large companies.

***Users of financial statements***

There is a clear and uniform pattern that the users of financial statements differ with the size of company:

- For micro companies, the owner-manager structure is the most prevalent. There are few other stakeholders due to limited influence of the company on its surrounding environment. A Eurobarometer survey[96] found that 78% of micro companies considered banks as their main source of finance, followed by leasing companies (22%) and public institutions (10%). Private investors constituted only 7% and venture capital companies 2% of all answers[97]. On the basis of information from stakeholders, also supported by statistical information, Eurobarometer[98] estimates that only 7% of all micro companies in the EU (regardless of their legal form) are involved in export. Moreover, 95% of companies with less than 10 employees do not have any foreign subsidiaries.

- Generally, stakeholders of small companies are limited and differ significantly from those of big corporations. These companies are in most cases owner-managed - or there is a close relationship between the owners and the managers. Therefore statutory financial statements do not have the same relevance for the shareholders in reviewing the company's performance. Investors in small companies are often limited in number, often directly involved in running the company and with direct access/insight into the company's accounts. The source of financing is not the stock market but own resources, credit from banks or other financial institutions.

- Large and medium-sized companies have significantly larger group of stakeholders interested in monitoring their performance. Due to their size these companies have a bigger impact in their environment and (in addition to shareholders) they have a bigger number of other stakeholders. These include for example employees, public authorities, clients, business partners, other companies / competitors, and public at large. These stakeholders, have generally, less often, direct access to management data. Financial statements tend to be the main (or only) source of financial information.

As a result, different users of financial statements have different needs according to the size of companies.

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[96] Eurobarometer in 2005 conducted a survey on EU15 SMEs access to finance. The population studied comprises all legal forms of companies, i.e. not only limited liability companies covered by the Directives. However due to lack of more precise studies the results of this survey may be indicative of general sentiment in the SME group that should not differ significantly for limited liability companies.

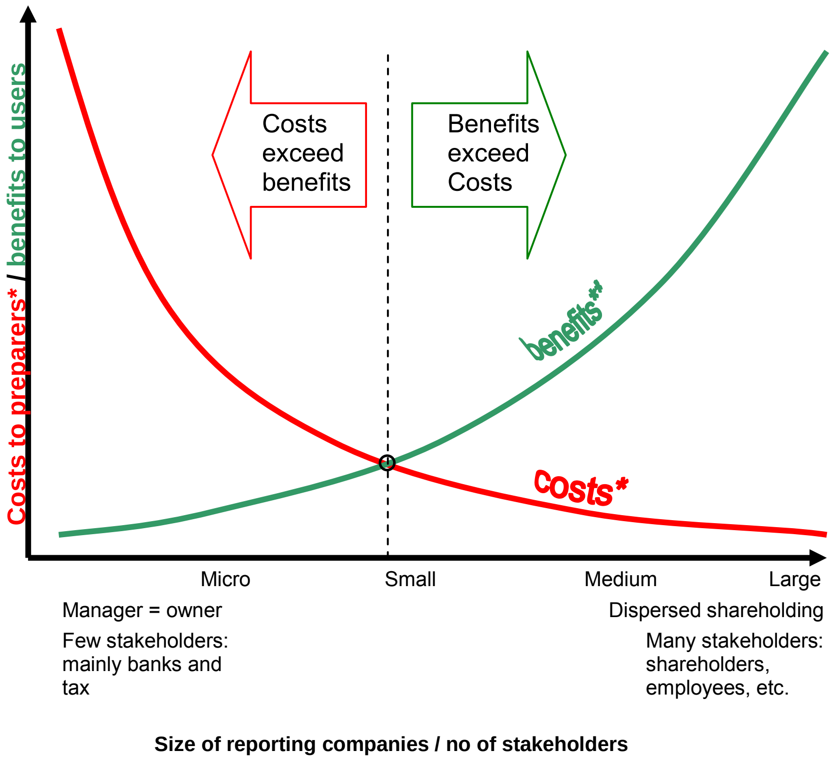
[97] The percentages do not add up to 100% as it was possible to select more than one source of financing.

[98] See EUROSTAT 74/2007, Statistics in focus: Export of business services, available at http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-07-074/EN/KS-SF-07-074-EN.PDF

### *Balance between costs and users' needs*

The figure below illustrates evolution of the cost / benefit balance of current requirement in relation to company size.

*Fig. 4 - Cost / benefit analysis of reporting requirement by company size.*




* - Costs are presented as percentage of total cost of company
** - Benefits as percentage of total information about a company that is gained from published financial statements
*Source: Commission Services analysis*

Looking at the issue from an agency theory viewpoint, literature indicates that as regards smaller companies, agency relationships differ compared to large companies and the stewardship function is largely absent in small companies. Instead, the financial statements appear to play an agency role between the owner-manager and the bank[99]. The main users of financial statements are usually found to be the owners themselves[100], tax authorities and banks[101]. It is also suggested that there is an obvious demand for differentiated reporting requirements associated with business size and structure[102] and also that the needs of the smallest companies are best served by a system developed by national regulators, taking into account their specific economic environment.[103]

The other main stakeholders are the tax authorities, lenders and business partners. Usually these stakeholders have the powers to obtain direct access to financial information, and they

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99 E.g. Collis and Jarvis 2000
100 E.g. Abdel-khalik 1983; Carlsberg et al 1985 and McCahey 1986
101 E.g. Page 1984; Pratten 1998; Collis and Jarvis 2000
102 Holmes, Kent and Downey 1991
103 Evans et al 2005

do not rely on the published financial statements[104]. As regards the stakeholders, the following general characteristics can be identified:

- Users of small company financial statements are few and most of them have power to demand customized financial statements (e.g. tax authorities, banks) while owners are interested in much more detailed information for managerial purposes than that presented in the financial reports. Such information is delivered by the enterprise's accounting system. At one end of the spectrum there is a special group of companies whose manager is also the (only) owner. In this case the manager has a direct access to financial information about the company and would not need general purpose financial statements.

- Tax authorities are mostly interested in calculation of taxable income according to tax law which often uses different valuation, measurement and recognition rules to those used in the financial statements.

- Creditors/banks are interested in calculation of recoverable amount of assets as collateral to granted credit – a recent survey of German banks[105] showed for example that figures produced by more sophisticated (and complex) accounting methods are not helpful. On the contrary, for example when analyzing financial statements banks tend to eliminate "intangible assets" and "deferred tax assets" from the total recoverable assets. Banks also often rely on other sources of information, such as cash flow projections because statutory financial reporting is not forward looking and timely enough. Representatives of banks have mentioned that for example the transactions on the bank accounts are often of more relevance as a source of information than the statutory financial statements.

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104 E.g. Deaconu et al 2009: "*the significant users […] are the shareholders-managers, and to a little extent the financial creditors. Their needs can be satisfied through internal information, less formalised if it is about managers and through information upon request if it is about the other external financing bodies. All these converge on supporting the simplification of the content and of the reporting manner of the accounting information* […]."

105 DRSC, UR. 2008. Financial Reporting from the Perspective of Banks as a major User Group of Financial Statements. p.27, http://www.standardsetter.de/drsc/docs/press_releases/080917_ASCG_Surveyontheexpectationsofbanks.pdf

## ANNEX 5
## Estimation of administrative burden reduction through full use of existing exemptions

Based on the report "*EU project on baseline measurement and reduction of administrative costs*" by Consortium[106], the following table presents estimates of the burden reduction potential if the Member States were making full use of some of the exemptions offered by the Fourth Directive :

**Estimation of administrative burden reduction through full use of existing exemptions.**

| Art | Exemption | Estimated administrative burden reduction (€) Micro | Small | Medium -sized | Total |
|---|---|---|---|---|---|
| 11 | Small companies definition, abridged balance sheet. | 91,063,909 | 21,918,777 | 0 | 112,982,686 |
| 27 | Medium companies definition, simplified Profit and Loss account layout. | 39,214,746 | 14,640,465 | 2,389,720 | 56,244,931 |
| 44 | Abridged notes for small entities. | 25,546,254 | 9,341,882 | 0 | 34,888,136 |
| 45 | Certain simplification of disclosures in the notes. | 67,810,872 | 25,182,240 | 6,352,388 | 99,345,501 |
| 46.3 | Exemption for small companies to prepare annual report. | 117,272,759 | 24,762,992 | 0 | 142,035,751 |
| 46.4 | Certain simplifications for medium companies in the annual report. | 56,614,015 | 17,515,488 | 3,988,270 | 78,117,773 |
| 47.2 47.3 | Simplifications of publication requirement for small and medium companies. | 124,656,708 | 80,801,230 | 3,306,574 | 208,764,512 |
| 51.2 | Exemption for small companies from audit. | 1,303,097,224 | 495,819,610 | 0 | 1,798,916,834 |
| 57 | Exemptions for certain subsidiary undertakings | n/a | n/a | n/a | 824,236,589 |
| Total | | **1,825,276,487** | **689,982,684** | **16,036,952** | **3,355,532,712** |

Note: Art. 57 - Exemptions for certain subsidiary undertakings: the breakdown of the total per size of companies is not available. Should this amount be considered, savings available to small and medium-sized companies would be higher than those reported in this Impact Assessment.
Please also note that the numbers presented above (with exception of Article 51.2), take into account only estimation for the Member States that did not transpose the relevant articles at all, and do not address transpositions that impose additional restrictions to the full use of exemptions.

*Source: Consortium study 2009, Commission Services analysis.*

Were all of these exemptions to be used by the Member States, the administrative burden for all companies could be reduced (according to the calculation of the Consortium) by as much as €3.3bn, with audit exemption for micro and small companies contributing the bulk of the sum. If only small and medium-sized companies are considered, the savings would amount to at least €0.7bn.

[106] See EU Project on Baseline Measurement and Reduction of Administrative Costs, by Consortium (Capgemini, Deloitte, Ramboll), available at http://ec.europa.eu/enterprise/policies/better-regulation/documents/files/abs_development_reduction_recommendations_en.pdf

## ANNEX 6
## Policy options in the frame of a review of the Accounting Directives

This Annex which corresponds to section 5.2 in the body of the document identifies, analyses and compares detailed policy options that could constitute the substance of a European level action. The extent to which options have been examined in this Annex is limited due to the policy choices favoured in section 5.1 that have led to consider a review of the existing Accounting Directives as the preferred overall option. For the same reasons, the Baseline scenario is not examined again in this Annex.

The issues raised in the Problem Definition section can be examined in the light of the folowing statements:

- While **small companies** suffer most from the administrative burden of the current reporting requirements, it also seems that the users of these companies' financial statements have the least need for sophisticated accounting and extensive disclosures. Also, even though the Member States may allow small companies to file abbreviated financial statements (a balance sheet with any notes pertaining thereto), the Directives require these same companies to continue to prepare detailed financial statements for their shareholders. The option offered to Member States to allow small and medium-sized companies to prepare abridged accounts does not prevent from preparing fully fledged notes. All these requirements tend to come in addition to local reporting requirements (tax returns, statistics).

- **Medium-sized and Large companies** require more sophisticated accounting regimes due to the greater complexity of their operations and because their main stakeholders often have less direct access to management information. The clarity and comparability of information is key whereas the Accounting Directives allow for many different accounting treatments because of the numerous options offered to the Member States. The information presented by smaller companies could be streamlined, but nevertheless it should be based upon a framework of accounting principles common to small, medium and large companies.

- The **categorization of companies by size** varies from one Member State to another. Hence companies of similar sizes within the EU can be considered as large, medium or even small depending on the Member State where it is located. This is made possible as the Accounting Directives provide for upper limit thresholds (based upon headcount, balance sheet assets and turnover) that Member States can transpose with lower figures.

The objectives of the revision of the Directives are that small companies should have simpler, yet clearer and comparable financial reporting than today. It is estimated that there are around 1,117,000 small companies in the EU which are in the scope of the Fourth Directive.

The objectives from the revision of the Directives for medium and large companies are narrower, being an improvement in the clarity and comparability of financial reporting. It is estimated that there are respectively 245,000 medium-sized and 45,000 large companies in the EU which are in the scope of the Fourth Directive.

The thresholds for the different categories of companies used in this section, using the current definitions in the Accounting Directives and the proposed definition for micro-companies, are as follows, before considering Option 2 consisting in the revision of the thresholds:

**Thresholds for the different categories of companies.**

| Category / Threshold | Micro | Small | Medium |
|---|---|---|---|
| **balance sheet total** | ≤ € 500,000 | ≤ € 4,400,000 | ≤ € 17,500,000 |
| **Net turnover** | ≤ € 1,000,000 | ≤ € 8,800,000 | ≤ € 35,000,000 |
| **Average number of employees during the financial year** | ≤ 10 | ≤ 50 | ≤ 250 |

*Source: The Fourth Directive 1978, Communication from the Commission on a simplified business environment for companies in the areas of company law, accounting and auditing 2007.*

In light of the problems and objectives identified, policy options regarding all companies could include the following:

***Options with an overall reach***

(1) Harmonising the definitions of the size of companies under the Directive; and/or

(2) Increasing the company size thresholds; and/or

(3) Mandating the preparation of financial statements under an electronic format such as XBRL;

***Options with an overall reach (mutually exclusive)***

Either

(4) Harmonising and clarifying certain basic principles; and/or

(5) Reducing the number of options available to Member States;

or

(6) Developing a European Accounting Standard;

***Options specific to small companies (mutually exclusive)***

(7) Simplifying layouts or requiring only key financial data instead of a fixed balance sheet and profit and loss account structure (mainly for small companies); or

(8) Reducing the information given in notes by small companies and ensuring harmonisation across the EU ("mini-regime");

***Options specific to medium-sized / large companies***

(9) Introducing a compulsory cash flow statement for certain categories of company.

***Policy option 1 – Harmonising company size definitions across the EU***

Company categories currently include small, medium-sized and large companies, and could soon include a new category relating to micro companies. In order to categorise companies, Member States can currently set lower thresholds than those permitted in the Directives. As a result, companies that would be considered small or even micro under the Directives may, for instance, be considered as large under Member States' law, thus imposing more burden than that intended by EU law. Based on a survey conducted among the Member States[107] only eight have transposed or are about to transpose the maximum amounts of turnover, balance sheet assets and headcount permitted in the Directives for small companies. Other Member States use slightly lower to significantly lower amounts.

The harmonisation of thresholds across the EU would *de facto* entail a shift downwards to a lower size category for many companies in the EU. Such a shift towards harmonised definitions will remove competitive disadvantages currently faced by certain EU companies located in Member States with lower thresholds than those permitted in the Directives. This would also achieve a significant burden reduction for those companies becoming subject to a downward re-categorisation of size. At the same time, those Member States that currently have not implemented the whole range of company categories would have a more complete system to implement. This is the case for Belgium, Bulgaria, Czech Republic, Estonia, Greece, Finland, France, Hungary, Italy, Lithuania, Poland, Romania, Slovakia and Sweden.

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small/medium/large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 1. Harmonising company size definition across the EU | Small, Medium, Large | ++ | ++ | + | - | Yes |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

The impact of harmonising the thresholds in the EU for all companies up to the current highest levels in the Directives has not been calculated separately, mainly due to limitations in data collection. However, the calculations of the impacts made elsewhere in this document include the impact on savings or costs based on the assumption that such harmonisation has been achieved.

***Policy option 2 – Increasing the company size thresholds***

Article 53 (2) of the Fourth Council Directive calls for a review of the amounts expressed in the Directive every five years. The last revision of the thresholds defining small and medium-sized companies took place in 2006[108]. In the context of the review of the Directives and in line with the objective to reduce administrative burden it may therefore be timely to consider

107 See Commission survey at http://ec.europa.eu/internal_market/accounting/docs/2010-options_en.pdf

108 Thresholds defining SMEs are available at http://ec.europa.eu/internal_market/accounting/sme_accounting/thresholds_en.htm

an increase. Considering the need to regularly revise these thresholds in the future, appropriate powers could be delegated to the Commission, based on predefined criteria.

With an increase of monetary thresholds by around 14 per cent we arrive at the following figures, out of which two would have to be met for any company to fall within a particular category:

| | Small companies | Medium-sized companies |
|---|---|---|
| Balance sheet total (EUR) | ≤ € 5,000,000 | ≤ € 20,000,000 |
| Net turnover (EUR) | ≤ € 10,000,000 | ≤ € 40,000,000 |
| Average number of employees during the financial year | ≤ 50 | ≤ 250 |

*Source: Commission Services.*

As a result of this threshold increase 62,000 medium-sized companies would shift to the small category. The average number of employees during the financial year measure, which has worked well over the years, would not be changed.

The Member States that have transposed the maximum threshold levels are expected to support this change. In the 2009 consultation, smaller Member States tended to say that the current thresholds were too high, whilst those from the large Member States thought that they were too low. In the context of the same consultation, there were calls for periodic inflation adjustments to the thresholds.

Raising the thresholds will result in a reduction of administrative burden by €0.2bn peryear.

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small/medium/large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 2. Increasing the company size thresholds | Small, Medium, Large | ++ | ++ | 0 | - | Yes |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

***Policy option 3 – Mandating the preparation of financial statements under an electronic format such as XBRL***[109]

Stakeholders have repeatedly highlighted that different reporting requirements for similar or identical information for different purposes is regarded as a big administrative burden. A system whereby enterprises could fulfil most of their information requirements by providing the information to others (national tax or statically authorities, banks, company registers, etc.) following the "only once" principle or "one-stop shop", would be seen as a major improvement. Initiatives such as e-government programmes at Member State level or BRITE[110] at EU level stem from this principle. Requiring financial reporting under the XBRL electronic format could make it easier to: speed up filing; prepare consolidated financial statements; provide uniform data and creates an opportunity to centralise reporting, which would allow the integration of national reporting systems with business registers and publishers.

Asked about XBRL in the 2009 consultation on the review of the Accounting Directives, respondents stated that electronic tools could contribute to the creation of a one-stop shop reporting system (whereby a company is only required to file its financial statements once to meet various users' needs). The benefits of XBRL data tagging were outlined for financial analysis used by large groups, banks or financial analysts. For instance, interactive reporting separates data from visualisation tools and everybody can have the layout he likes or needs. Some argued that the choice of using an electronic format should be for companies to decide.

Making financial statements accessible and easy to analyse would contribute to increased transparency of financial information and would be accompanied by potentially cheaper credit, higher market confidence, enhanced competition, and the extension of trade (within and outside EU) thus improving access to the single market for businesses.

There could be potentially relatively significant setup costs for smaller business if XBRL were to be required as a reporting format, as the "XBRLsation" would necessitate the update or purchase of software, as well as broadband internet connection. Anecdotal evidence indicates that a not-insignificant proportion of smaller companies do not have access to a computer[111]. Mandating electronic filing would therefore necessitate either the computerisation of all micro companies that have no computer yet, or outsourcing the electronic filing to a third party (external accountant, service provider, etc).

More importantly, a major stumbling block is that smaller companies have no direct benefit to expect from XBRL other than the potential for reduced costs resulting from the implementation of one-stop shops or swift IT transfer solutions. Yet, nothing ensures to date that all Member States will effectively implement one stop shop solutions or IT based communications. Mandatory electronic filing under XBRL at EU level for financial

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109 XBRL stands for eXtensible Business Reporting Language. It is a language for the electronic communication of business and financial data. It is already being put to practical use in a number of countries and implementations of XBRL are growing rapidly around the world. http://www.xbrl.org/Home/

110 The goal of the Business Register Interoperability Throughout Europe (BRITE) project is to interconnect business registers throughout Europe. http://www.briteproject.eu

111 According to a research report commissioned by the HM Revenue & Customs of the United Kingdom: ‘The Extent and Nature of the use of Computerised Accounting by Businesses to meet their VAT and Corporation Tax Obligations" published in December 2008, 10% of businesses do not have access to a computer.

statements therefore appears unnecessary and potentially disproportionate as long as the conditions ensuring that companies will ripe full benefits from such measure are not in place.

Electronic filing systems are already developed or in place in certain Member States. A variety of standards are currently in use for that purpose in Member States: beyond XBRL (Belgium, Italy, Germany and others[112]) used or contemplated by many Member States, some Member States use XML (Portugal, Slovenia) or proprietary standards. Considering a shift to XBRL by those MS would require an analysis of potential benefits and costs as any change in technology needs initial investments.

It appears that the proponents of widespread electronic filing such as XBRL come from either the private sector (e.g. banks, larger companies) or national governments considering that the reporting requirements originates from legislation at Member State level. Introducing XBRL or other forms of electronic filing at EU level as part of a review of the accounting obligations of companies therefore appears neither necessary nor proportionate at this stage.

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small/medium/large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 3. Mandating the preparation of financial statements under an electronic format / XBRL | Micro, Small, Medium, Large | 0 | 0 | ++ | + | No |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

### ***Policy option 4 – Harmonising and clarifying basic principles***

The Accounting Directives contain both principles, some detailed rules and numerous options. The fundamental principles could be made clearer and placed in a separate section in the beginning of the Directive. It is assumed that by doing so, the principles-based nature of the Directives would be much better emphasised and the readability and understandability of the Directives would be improved. Also the options that give a possibility for Member States to deviate from these principles could be removed to achieve more harmonisation on EU level.

Consultations with interested parties [113] indicated support for placing the basic principles in a separate section at the beginning of the Directive to improve the understandability, user friendliness and clarity of the Accounting Directives. The most commonly cited principles that stakeholders would like to see harmonised were the principles as regards substance over form and materiality.

112 For more information on other projects see http://www.xbrl.org/eu/frontend.aspx?clk=SLK&val=63

113 See the summary report available at http://ec.europa.eu/internal_market/accounting/docs/ifrs/2010-05-31_ifrs_sme_consultation_summary_en.pdf. 98% of respondents to question 1 agreed to group basic principles in one section of the Directive. Support for clarifying the basic principles was also expressed by the stakeholders that took part in the public consultation on the IFRS for SMEs carried out by the Commission in 2010.

At the same time certain terminology could be modernised and streamlined with other accounting literature. This could bring about more clarity. Such an approach received a favourable reaction from consultations with interested parties[114].

To mitigate any possible increase in burden associated with this approach it is also proposed that the principle of materiality should become a general principle in the revised Directive. Presenting non-material information entails unnecessary burden and also makes the financial statements less clear and less relevant for the users of financial reporting of companies of all sizes. A general principle of materiality will ensure that only essential accounting information is presented, and so will result in shorter and more succinct financial statements, which will be less costly to prepare. In practice, this would allow financial statements' preparers to disregard any requirements of the Directive where the information provided to users would be of limited value or significance. For example, one profit and loss account layout in the Fourth Directive requires the presentation of 23 separate lines of income and expenditure. Applying the principle of materiality would mean that the preparer could ignore those lines of income and expenditure where the amounts involved were only trivial, so the profit and loss account presented could be much shorter than the 23 lines prescribed.

There would also be a general requirement that the commercial substance of a transaction be presented. Such a means of presentation is currently permitted by the Directive, and 17 Member States require it. But there may be increased burden from introducing such a requirement in the 10 Member States that have, so far, not followed this principle[115]. It is likely that the most common transaction to be effected would be longer-term leases, so called finance leases. The assets used under such leases would need to be included in the balance sheet, and liabilities would need to be recognised for future lease payments due to the lessor. Whilst accounting in this manner in annual or consolidated financial statements will require, in a number of cases, the use of professional accountant time, accounting for leases as an operating lease would ordinarily require analysis by a professional accountant to ensure that advance payments/rentals paid at the inception of the lease are properly treated as prepayments. Hence the incremental effect of accounting for leases as finance leases may be limited. Equally in many cases the lease concerned will be immaterial to the financial position of the company.

Accounting for the commercial substance of a transaction is considered to provide users with more relevant information with which they can make economically sound decisions. To bring about a more harmonized treatment in this regard the option should be removed so that accounting for the commercial substance of a transaction becomes a general principle applicable to all companies.

It is estimated that the introduction of these two general principles will have a combined neutral effect overall on administrative burden, even though uneven per company. It is

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114 Ibid. Around 85% of respondents who gave answer to question 36 of 2009 Consultations supported modernisation of wording and terminology in the directives. Authorities from 12 countries (out of 13 who responded), lobbyists and pan-EU organisations were in favour. The concerns raised referred to legal certainty, conversion costs and applicability of older court rulings. Support for the modernisation objectives was also expressed in occasion of the stakeholders' meeting on the Review of the Accounting Directives and IFRS for SMEs organised in Brussels on 25th May 2010, see http://ec.europa.eu/internal_market/accounting/docs/ifrs/2010-05-25-ifrs-sme%20meeting_minutes_en.pdf

115 Austria, Belgium, the Czech Republic, Denmark, Finland, France, Latvia, Sweden, Slovakia Slovenia.

assumed that any increase in burden from accounting for the substance of transactions is mitigated by a burden reduction from no longer having to present immaterial transactions. In certain Member States, the introduction of these principles could have an impact on national legislation (such as tax).

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small / medium / large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 4. Harmonising and clarifying basic principles | Small, Medium, Large | 0 | 0 | ++ | ++ | Yes |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

***Policy option 5 – Reducing the number of options available to Member States***

Under this option, t he proposal would involve removing significant numbers of Member State options to create a more harmonised European accounting framework. The following commentary gives some examples of areas of the Directives where options could be removed:

**Layouts:** The use of differing layouts hinders direct comparison of the performance, profitability, and financial position of companies. Two balance sheet layouts are permitted by the Fourth Directive. By moving to one balance sheet layout, information provided to users on companies' financial position would be fully standardised across the Community. By moving from the current four possible profit and loss account layouts to two, greater comparability of companies' relative performance would become possible[116].

**Disclosures / Notes to the financial statements:** The Directives require additional financial information to be disclosed, in notes to the financial statements, to further inform users about certain aspects of a company's performance, profitability and financial position. Much of this additional information is descriptive, and therefore would not be suitable for inclusion in the profit and loss account or balance sheet. Furthermore, disclosing information by way of notes avoids the profit and loss account and balance sheet being cluttered with information, often of less importance. An extensive range of disclosures is currently required, from analyses of turnover by activity and geographical market through to explanations of different classes of share capital. To reduce burdens upon smaller companies the Directives have permitted the Member States to exempt such companies from some of these disclosures. However, the take-up of these options by the Member States is far from uniform, so the disclosure regime is different in every Member State. Whilst this obviously prevents direct comparison of similar businesses' results in different Member States, it can also lead to distortions in the competitive environment as certain business sensitive information can be disclosable in certain Member States, whilst it remains confidential in others.

116 It is not considered desirable to move to one single profit and loss layout as there should remain the possibility of presenting expenditure information according to either its function e.g. distribution costs, or its nature e.g. raw material costs. For instance, the performance of a manufacturing company may be best understood when a "by nature" presentation of the profit and loss account is used

To overcome these difficulties the disclosure regime across Europe could be harmonised. Harmonised disclosures would benefit all EU micro and small companies from a simplification perspective. Medium and large companies would have to make further disclosures, broadly in line with current requirements, but these would be harmonised in line with a "building block approach" to reflect greater user needs from the financial statements of larger companies.

**Valuation:** A number of different valuation methods are permitted by the Directives. This can result in similar transactions being accounted for differently in different companies, leading to a loss of comparability between reported profits or losses, and the asset side of the balance sheet. The valuation of stocks is one area where greater harmonisation is possible. Currently two diametrically opposed valuation methods are permitted: FIFO (first in, first out) and LIFO (last in, first out). FIFO values stock by assuming that the oldest items of a particular stock line would be sold before more recently acquired stock. LIFO values stock by assuming that a business would sell the most recently acquired items in a particular stock line first. Where stock prices are volatile or rising over time the two methods can give very different stock valuations, and can affect reported profitability. LIFO would tend, other things being equal, to give a lower reported profit and lower stock valuation than FIFO.

A policy option is to no longer allow LIFO as a valuation method within the revised Directive. This together with the removal of other options around inflation accounting and replacement cost accounting (a special method of revaluing fixed assets) would lead to greater comparability in reported profits/losses and the valuation of assets generally.

**Consolidation:** There is a general requirement within the 7th Directive that a parent company should include all its subsidiaries within its consolidated (or group) financial statements. This ensures that the consolidated financial statements give a true and fair view of the performance and financial position of the group as a whole. There is currently an option on whether so called "special purpose entities" (or SPEs) are consolidated or not - a SPE is an entity created by a sponsoring company to achieve a narrow, specified objective such as the granting of a lease. But, as illustrated in the financial crisis, the sponsoring company is very often liable for any losses the SPE may incur. This indicates that in reality SPEs are often little different to other subsidiaries, and therefore to ensure that the consolidated financial statements of groups with interests or investments in SPEs are comparable, it would be necessary that the Directive should move to a harmonised position whereby all such entities are consolidated.

The 7th Directive also allows, in certain conditions, alternative methods of consolidation. The standard approach (known as acquisition accounting) typically involves goodwill being recognised as an asset within the balance sheet. The alternative method (known as merger accounting) presents consolidated financial statements without goodwill. Given that goodwill can sometimes be the single largest asset in a consolidated balance sheet, and the amortisation or impairment of such goodwill can be a significant expense in the profit and loss account, consolidated financial statements prepared using the different bases would lack direct comparability. A possibility is to therefore allow only one method, that being acquisition accounting, which is the most commonly used option and which allows for the presentation of goodwill, which is a key accounting number to many users.

All of the above possibilities received wide stakeholder support during the consultation made in 2009 on the Review of the Accounting Directives, as a preferred means to simplify and increase the clarity and comparability of financial reporting for EU companies. Business stakeholders were of the opinion that whilst the options may only reflect the wide variety of tax or other systems within the EU and therefore be useful to a certain extent, the main drawback is that options allow the Member States to comply with the Directive without any incentive to seek actively to improve the business environment. The accounting profession supported as few options as possible for reasons of comparability and enhancement of the internal market. A number of respondents representing Member States' authorities were in favour of eliminating options as much as possible while pointing out that some of the options would have to be kept as they relate to divergences in Member States' domestic economic, legal and fiscal situation.

Overall, it should be possible to reduce the current number of around 120 options available to Member States, in the Accounting Directives, down to around 35, without impairing the ability of companies to prepare clear and meaningful financial statements. Options remaining, i.e. around 30 for the individual financial statements and 5 for consolidated financial statements do seem necessary to ensure further simplification for SMEs, to allow compliance with the generally accepted layouts (e.g. profit and loss account by function / nature), etc.

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small / medium / large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 5. Reducing the number of options available to Member States | Small, Medium, Large | 0 | + | ++ | 0 | Yes |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

***<u>Policy option 6 – Developing a European Accounting Standard</u>***

The Directives are principles based by nature. That is, they provide for basic accounting principles such as prudence, accruals, consistency etc. with an overriding obligation that financial statements should show a true and fair view. However most commentators would agree that they cannot be seen as a fully fledged accounting framework.

A possible way of ensuring clarity and comparability may be to use the Directives as a vehicle to develop and introduce a European Accounting Standard addressing both individual and consolidated financial statements. This would require the Directives to become much more rules based than they currently are, much lengthier as detailed provisions would be needed to prescribe how certain transactions should be accounted for (for instance, there would need to be sections on leasing, revenue recognition, pensions, areas in which the current Directives are silent). Equally as the business environment continually evolves and develops there would be a need for frequent revisions. To develop a standard that at the same time offers a robust reporting regime for large companies, but would be simple for smaller companies to deal with would be very challenging.

Developing an EU centralised accounting framework would prevent the Member States from tailoring their accounting framework to their needs and it would take a very long time to negotiate. Such an option would also require establishing an EU accounting standard setter. The appetite for such an approach with the Member States would therefore be limited, with many preferring the current primarily principles-based approach.

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small/medium/large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 6. Developing a EU accounting Standard | Small, Medium, Large | ? | + | ++ | ? | No |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

***Policy option 7 – Simplifying layouts or requiring the presentation of only key financial data instead of a fixed balance sheet and profit and loss account structure (mainly for small companies)***

Currently the Directives allow for two layouts for the balance sheet and four layouts for the Profit and Loss (P&L) account. Additionally Member States may allow for a current/non-current presentation of balance sheet items and a performance statement instead of a P&L.

One possibility could be to impose very limited balance sheet, profit and loss and note requirements. According to CSES, 68% of enterprises would take advantage of such a simplification of financial statements format, and 38% consider this would result in time or cost savings. However, banks did not support the potential loss of information. As far as burden reduction is concerned, this proposal is estimated to produce up to €0.2bn of cost savings per year for small to large companies[117] with an initial setup cost of up to €0.3bn (due to software updates, etc).

In the 2009 consultation on the review of the Accounting Directives, the Commission proposed a radical simplification to require only key financial data for smaller enterprises instead of a fully structured balance sheet and profit and loss. The vast majority of respondents did not support this idea because traditional financial statements are more meaningful to users, allow some comparability, give a better picture of a company's performance and offer less room to data manipulation.

The rather insignificant cost savings implied by such simplification could be outweighed by initial setup costs and the mixed views of stakeholders on this option. It seems that stakeholders are satisfied with the current layouts, and that priority should be given to further harmonisation of layouts (i.e. fewer layouts), a possibility which we also examine and for which public support seems stronger[118].

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117 See CSES 2010, p.7 and p 36, and EBTP questionnaire, available at http://ec.europa.eu/internal_market/accounting/docs/studies/2010_cses_4th_company_law_directve_en.pdf

118 See summary report of the responses received to the consultation paper on review of the Accounting Directives, p. 18, available at http://ec.europa.eu/internal_market/accounting/docs/200910_accounting_review_consultation_report_en.pdf

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small/medium/large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 7. Simplifying layouts or requiring only key financial data | Small | ++ | ++ | - | -- | No |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

***<u>Policy option 8 – Reducing the information given in notes by small companies and ensure harmonisation across the EU ("mini-regime")</u>***

Preparation of notes to the financial statements is the most time consuming part of the process especially for smaller companies. The notes are descriptive, require additional analysis and contain information that, most of the time, cannot be easily obtained from the accounting software. It is estimated that for small companies up to 50%[119] of time spent on preparing financial statements is devoted to the preparation of notes. On the other hand, users' needs should not be compromised.

The Commission contacted accounting experts (e.g. ARC working group, EFRAG) to identify the key notes that are most useful in understanding the financial statements and assessing the risks of a company. The following disclosures were considered as essential:

- Accounting policy and estimates;
- Guarantees and commitments, contingencies, arrangements;
- Related party transactions;
- Post balance sheet events;
- Amounts payable after five years and total secured debt.

Thus the option would be to eliminate all but these five disclosures for small companies. These disclosures would be contingent upon a materiality check, so small transactions or events that do not affect the overall picture of a company could be omitted.

The limitation of disclosures will reduce the burden mainly in the Member States that have made only moderate use of exemptions, as described in Section 3.4.2: Cyprus, Czech Republic, Greece, Spain, Finland, France, Ireland, Poland, Romania, Sweden and Slovakia.

[119] CSES 2010, p.39

However a detailed analysis on the extent to which small companies are currently exempt of the above obligations indicates that small companies would nevertheless be subject to new obligations in many Member States. The table below outlines the current situation within each Member State with respect to these disclosures by small companies:

| | | Member States (shown with O) where small companies are currently exempt from the obligation …. | | | | | |
|---|---|---|---|---|---|---|---|
| | | **To disclose accounting policies and estimates in the notes** | **To disclose details of "off balance sheet" financial guarantees and commitments, including regarding pensions and affiliated undertakings in the notes** | **To disclose details of off balance sheet arrangements in the notes** | **To disclose related party transactions in the notes** | **To disclose post balance sheet events in the annual report** | **To disclose the amounts payable after five years and total secured debt (at least in total) in the notes** |
| AT | **Austria** | | O | O | O | O | |
| BE | **Belgium** | | O | | | O | |
| BG | **Bulgaria** | | O | O | | O | |
| CY | **Cyprus** | | | | | | |
| CZ | **Czech Republic** | | | | | O | |
| DE | **Germany** | | O | O | O | O | |
| DK | **Denmark** | | | O | O | O | |
| EE | **Estonia** | | | | | | |
| EL | **Greece** | | O | | | | |
| ES | **Spain** | | O | | | O | |
| FI | **Finland** | | O | | | O | |
| FR | **France** | | | | | | |
| HU | **Hungary** | | O | O | O | O | |
| IE | **Ireland** | | O | O | O | | |
| IT | **Italy** | | O | O | O | O | |
| LT | **Lithuania** | | O | O | O | O | |
| LU | **Luxemburg** | | O | O | O | O | |
| LV | **Latvia** | | O | O | O | | |
| MT | **Malta** | | O | O | O | O | |
| NL | **Netherlands** | | | O | O | O | |
| PL | **Poland** | | | | | | |
| PT | **Portugal** | | | | | | |
| RO | **Romania** | | | | | | |
| SE | **Sweden** | | | O | O | | |
| SK | **Slovakia** | | O | O | O | O | |
| SL | **Slovenia** | | O | O | O | | |
| UK | **United Kingdom** | | | O | O | | |

*Source: Commission analysis base Source: survey on Member States published by the European Commission in 2011*

The disclosure of *accounting policies* briefly outlines the fundamental principles used in preparing the financial statements, including measurement and valuation rules, and items for which measurement methods other than historic cost are used. In most cases accounting policies are stable, and currently being disclosed by all companies as mandated by the Directives. So in terms of burden, this disclosure is assumed to be cost neutral.

*Guarantees and commitments* show the exposure of a company to potential liabilities that are not shown on the face of the balance sheet but may materialise in the future. As such they are important for the analysis of a risk of the company. For example, where a company guarantees the borrowing of an associated company, *Contingent liabilities* are the exposure to potential losses dependent upon future events (e.g. litigation, where a company could risk paying an award of significant damages which could impact upon its financial position). An example of an *arrangement* is a special purpose entity transaction, although these are uncommon for smaller companies.

In the CSES study banks were unanimously of the view that disclosures on guarantees and commitments (including information on amounts payable after more than five years and details of amounts payable where valuable security had been given) are necessary and that if they were not in the financial statements companies would be asked for this information anyway. Accounting associations and firms also agreed that this information is necessary although accounting firms added that it is less important for companies that do not use bank finance.

Many Member States have made their small companies exempt of the obligation to disclose guarantees, commitments, arrangements, etc. As such, to introduce disclosure for small companies would be akin to require a new requirement. The corresponding increase in administrative burden for small companies is expected to cost around €159m annually and €43m in one-off system change costs[120].

*Related party transactions* are transactions entered between a company and its owners or managers (e.g. a shareholder renting a personally owned property to his company). Their disclosure can indicate the inter dependency of the company and its owners and can reveal non-arms-length transactions.

Many Member States have made their small companies exempt of the obligation to disclose related party transactions. Making this mandatory would be akin to a new disclosure requirement in 15 Member States. This is expected to cost small companies around €95m annually with €25m in one off system change costs[121].

In the CSES study, banks said that they ask for this information anyway whether it is in the statutory accounts or not. Accounting associations and accounting firms were of the opinion that it is useful to include this information in the financial statements.

*Post balance sheet events* are events which arise after the accounting period end but before the date on which financial statements are approved (e.g. a destruction of a company's premises due to fire after year end). Their disclosure ensures that the reader of the financial statements is not mislead by the important transactions/events after year end and is better placed to be able to assess the going concern. Whereas many Member States have exempted their small companies from disclosing such information, making this mandatory would cost virtually nothing to companies as it is seldom that post balance sheet events have to be disclosed (depends on whether post balance sheet events have actually taken place).

*Disclosing amounts becoming payable after more than 5 years and secured debts* presents the amount of long-term and secured debt (that is where a lender has a right to take possession of assets in a default). This disclosure assists unsecured creditors to assess the assets available in insolvency. In the current regime small companies need to present the information. As such this disclosure is deemed cost neutral.

Moving to the disclosure of only the five items above is expected to reduce financial reporting costs annually by around €962m, taking account of the fact that some provisions would

[120] CSES 2010, p36 table 8.3 and 8.6
[121] CSES 2010, p36 table 8.3 and 8.6

increase costs by respectively €159m and €95m, i.e. €254m in total based on CSES study as explained above. This represents additional costs of €227 in average per small company, a figure which has been posted in Annex 7 under caption "Additional Costs per Company Resulting from Preferred Policy Option #8".

*Audit*: Due to the "think small first" approach, there would be no requirement for small companies to have a statutory audit in EU law.

The Committee of the European Banking Supervisors notes that audited financial statements are currently used by banks as part of the credit granting process. Any proposal to reduce the level of assurance given on SMEs financial information could have unintended consequences for the availability of credit for such business. However an audit, especially for the smaller companies, is not the primary source of information or comfort that finance providers use. According to academics, there is no real reason to require a statutory audit for all corporations, as most SMEs do not need one. For private entities, the users (banks, lenders, other users) should decide what type of service is needed[122]. The fact that the vast majority of Member States have made full or quite full use of the exemption offered by the Directive to exempt small companies from audit is a strong indicator supporting this assertion (see Table 2 in Section 3.4.2). Auditors tend on the contrary to not support further audit exemptions and put forward the benefits brought about by audits in raising confidence in financial information and their duties to address fraud at companies. Auditors, when intervening in companies, are subject to the obligations of the anti-money laundering directive and contribute to the fight against money laundering. It is expected that companies becoming exempt will use at least part of the savings to continue having an audit on a voluntary basis, or to buy other services from external accountants or auditors.

The potential for savings for companies where an audit is no longer required will be in the region of €0.5bn for small companies (see Annex 7). Whether an audit is required or not will depend on each Member State's policies, as the proposal would not foresee full harmonisation in this area. The most significant potential impact of removing the statutory audit requirement should be concentrated in the Member States which currently require a statutory audit for all or mostly all small companies (Cyprus, Finland and Sweden), and in the Member States where the threshold defining small companies and the audit exemptions are very low, as shown in Section 3.4.2 (Bulgaria, Czech Republic, Denmark[123], Estonia, France, Hungary[124], Lithuania, Latvia, Malta[125], Poland, Portugal, Slovakia). There should also be an impact, although relatively less pervasive, in the Member States which require an audit for all companies of one particular type whatever the size (such as e.g. public limited liability companies). These include Austria, Denmark, France, Greece, Poland, Portugal and Slovakia.

*Consolidated acounts of small groups*: The proposal would discourage Member States from requiring the consolidation of small groups, to be consistent with approach being followed for small companies' annual financial statements (thereby avoiding a small parent company

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122 Summary of the Green paper on Audit policy: Lessons from the Crisis, 2010. http://ec.europa.eu/internal_market/consultations/docs/2010/audit/summary_responses_en.pdf

123 In Denmark, only micro-companies with less than 12 employees, a turnover below DKK3,000,000 (≈€400,000) and/or a total balance sheet below DKK1,500,000 (≈€200,000) are exempted from audit.

124 In Hungary, the exemption from statutory audit applies only to small companies with less than 50 employees whose net turnover do not exceed HUF100,000,000 (≈€360,000).

125 In Malta, micro companies only – balance sheet lower than €46,587, Turnover lower than €93,175 and/or less than 2 employees – are exempted from audit.

having a "light-touch" annual financial statements regime, but unduly burdensome consolidated financial statements regime). Most Member States have already adopted the current option to exempt small groups from preparing consolidated financial statements into national law, However in Estonia, Greece and Romania, where there has until now been no exemption, this outright exemption will bring burden reduction.

*Maximum harmonisation*

Maximum harmonisation means that the Directives set the requirements and that the Member States cannot exceed those in their legislation. It brings more harmonisation and creates a level playing field by ensuring that no Member State can impose additional requirements and must use all the simplifications provided by the revision. This is especially necessary to ensure that any construct based on "think small first" is not distorted and actually delivers benefits for those companies that will remain in the scope of the Directives. Therefore, this approach is more effective from the point of view of reducing administrative burden.

Maximum harmonisation would entail some reduction of Member State discretion over the legislation. This as such may be a cause for some opposition. The Commission Services however believe that maximum harmonisation is achievable where the benefits are clearly demonstrated.

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small / medium / large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 8. Reducing the information given in notes by small companies and ensure harmonisation across the EU ("mini-regime") | Small | ++ | ++ | + | - | Yes |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis.*

***<u>Policy option 9 – Introducing a cash flow statement for certain categories of companies</u>***

The cash flow statement is a primary financial statement that can capture the flow of cash and cash equivalents in and out of a company. Or, as defined in the IFRS for SMEs: "The statement of cash flows provides information about the changes in cash and cash equivalents of an entity for a reporting period, showing separately changes from operating activities, investing activities and financing activities".

The preparation of a cash flow statement is currently not required by the Directives. It is however considered a useful tool to gauge the cash generating ability of the company.

Thus the Commission queried in the 2009 consultation on the Directives whether a cash flow statement should be required in the Directives. The majority of respondents supported such an approach but only for larger companies[126].

Several Member States currently require the preparation of a cash flow statement as permitted – but not required – by Article 2.1 of the Fourth Directive. The CSES study shows that the vast majority of medium and large companies already prepare a cash flow statement, whether for internal purposes of for publication, but less than half of small and micro companies prepare one. Banks said that where there was no cash flow statement available they could use software to generate cash flows relatively easily and carry out more sophisticated analysis or they asked firms to prepare the cash flow statements themselves. Some banks were of the view that if a simplified cash flow statement was to be introduced that could reduce the usefulness of information available. Accounting associations and firms said that a cash flow statement could be easily generated from the data collected already.

If the cash flow statement were to be introduced it would therefore create an additional cost mainly for micro and small companies of up to €1bn a year, with set-up costs of up to €1.5bn. For medium-sized companies, additional costs would be in the region of €13m in annual cost and €20m in setup cost. For large companies, there would be virtually no additional costs[127].

The Commission Services believe that introducing the obligation to present a cash flow statement would not fit with the objective of administrative burden reduction for micro entities and small companies. In addition, despite strong stakeholder support, introducing such requirements only for medium-sized and large companies may not bring about significant increase in the clarification and comparability of financial reporting as the vast majority of these companies already prepare such statements in accordance with local requirements or market led demands.

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small / medium / large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| 9. Cash flow statement for certain categories of companies | Medium, Large | + | N/A | + | + | No |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis*

126 Around 73% of respondents to question 12 of 2009 Consultation considered that Cash Flow statement should be required by the Accounting Directives, out of these 87% found CF appropriate for large companies, 60% for medium-sized and 18% for small ones. In response to question 16 on current legal requirement to produce CF, public authorities from 11 (out of 15 who responded) said there have one, while 4 claim the opposite.

127 CSES, 2010

## Summary of options

| Option | Size of the companies mainly affected | Requirements targeted to the size of the company | Simplification and elimination of excessive requirements (small) | Clarity and comparability (small / medium / large) | Maintain information value of financial statements (relevance of information) | Preferred option (yes / no / N/A)? |
|---|---|---|---|---|---|---|
| **1. Harmonising company size definition** | Small, Medium, Large | ++ | ++ | + | **-** | **Yes** |
| **2. Increasing the company size thresholds** | Small, Medium, Large | ++ | ++ | **0** | **-** | **Yes** |
| **3. Mandating an electronic format / XBRL** | Micro, Small, Medium, Large | **0** | **0** | ++ | + | **No** |
| **4.Harmonising and clarifying basic principles** | Small, Medium, Large | **0** | **0** | ++ | ++ | **Yes** |
| **5 – Reducing the number of options available to Member States** | Small, Medium, Large | **0** | + | ++ | **0** | **Yes** |
| **6. Developing a EU accounting Standard** | Small, Medium, Large | **?** | + | ++ | **?** | **No** |
| **7. Simplified layouts or only key financial data** | Small | ++ | ++ | - | -- | **No** |
| **8. Reducing the information given in notes by small companies and harmonisation across the EU** | Small | ++ | ++ | + | **-** | **Yes** |
| **9. Introducing a cash flow statement** | Medium, Large | + | **N/A** | + | + | **No** |

"+" favourable, "++" highly favourable"-" unfavourable, "--" highly unfavourable; "0" neutral; "?" unknown; "N/A" not applicable

*Source: Commission Services analysis*

# ANNEX 7
# Breakdown of savings as a result of preferred policy options

## BREAKDOWN OF SAVINGS RESULTING FROM PREFERRED POLICY OPTIONS

**CURRENT ADMINISTRATIVE COSTS PER COMPANY DUE TO ACCOUNTING (AS PER BASELINE SCENARIO)**

| | Small (€) | Medium (€) |
|---|---|---|
| 1. Obligation to draw up annual account and disclosure of account | 2.178 | 1.847 |
| 2. Annual reports | 251 | 219 |
| 3. Auditing of annual accounts | 3.876 | 14.452 |
| 4. Auditing of consolidated accounts | 1.715 | 14.367 |
| 5. Consolidated accounts and consolidated annual reports | 1.293 | 1.473 |
| **AVERAGE COST** | **2.799** | **16.660** |

*Source: Consortium*

**ADDITIONAL COSTS PER COMPANY RESULTING FROM PREFERRED POLICY OPTION #8**

| | Small (€) | % cost | Medium (€) | % cost |
|---|---|---|---|---|
| 1. Obligation to draw up annual account and disclosure of account: harmonised obligation to disclose certain footnotes | 227 | 10% | | |

*Source: CSES and Annex 6 / Option 8 of this Impact Assessment*

**SAVINGS PER COMPANY RESULTING FROM PREFERRED POLICY OPTIONS**

| | Small (€) | % cost | Medium (€) | % cost |
|---|---|---|---|---|
| 1. Obligation to draw up annual account and disclosure of account | (1.089) | -50% | | |
| 2. Annual reports | - | - | | |
| 3. Auditing of annual accounts | (2.907) | -75% | | |
| 4. Auditing of consolidated accounts | (1.286) | -75% | | |
| 5. Consolidated accounts and consolidated annual reports | (970) | -75% | | |
| **AVERAGE SAVINGS** | **(1.264)** | **-45%** | **(2.478)** | **-15%** |

*Source: CSES, Consortium, Commission analysis*

| POPULATION OF COMPANIES** | Small | Medium |
|---|---|---|
| 1. Obligation to draw up annual account and disclosure of account | 1.117.214 | |
| 2. Annual reports | 470.282 | |
| 3. Auditing of annual accounts | 170.553 | |
| 4. Auditing of consolidated accounts | 21.841 | |
| 5. Consolidated accounts and consolidated annual reports | 33.657 | |
| **TOTAL** | **1.117.214** | |

*Source: Consortium, CSES*

** The population for items 2 to 5 are from Consortium study and have not been updated. The population for these items can be lower than total population because not all companies may have such obligations. The population of companies has been updated regarding item 1. on the obligation to draw up annual account and disclosures based on 2010 study by CSES.

Number of Medium-sized companies becoming small companies with higher thresholds: **62.395**

*Source: Commission estimate*

**TOTAL NET SAVINGS RESULTING FROM THE PREFERRED POLICY OPTIONS**

| | Small (€) | % savings | Medium (€) | % savings |
|---|---|---|---|---|
| 1. Obligation to draw up annual account and disclosure of account | (962.554.947) | 63% | | |
| 2. Annual reports | - | - | | |
| 3. Auditing of annual accounts | (495.819.610) | 33% | | |
| 4. Auditing of consolidated accounts | (28.098.000) | 2% | | |
| 5. Consolidated accounts and consolidated annual reports | (32.641.640) | 2% | | |
| **TOTAL** | **(1.519.114.197)** | **100%** | **(154.617.540)** | **100%** |

**TOTAL SAVINGS (€)** **(1.673.731.738)**

***REMINDER FOR INFORMATION PURPOSES: SAVINGS ESTIMATED FOR THE COMMISSION PROPOSAL OF 26.2.2009 AS REGARDS MICRO-ENTITIES***

| | Micro | |
|---|---|---|
| *Total administrative cost per company (€)* | *1.558* | |
| *Savings resulting from the removal of all administrative burden per company (€)* | *(1.169)* | *-75%* |
| *Total population of micro-entities* | *5.369.738* | |
| *TOTAL SAVINGS BEST ESTIMATE PROPOSAL 2009 (€)* | *(6.276.031.947)* | *NB: due to evolutions in time of the population of micro versus small companies, this amount cannot be added to the above savings in a fully consistent manner.* |

*Source: Impact assessement accompanying a Proposal for a Directive amending Council Directive 78/660/EC on the annual accounts of certain types of companies as regards micro-entities, 26.2.2009*

Methodology:

The amounts of administrative costs per company are given by a study commissioned by the European Commission to a Consortium of contractors (Ramboll, Cap Gemini, Deloitte) and published in 2009. These costs have not been updated (e.g. inflation, further studies).

The savings per company are calculated on the basis of a study performed by CSES in 2010 available at http://ec.europa.eu/internal_market/accounting/docs/studies/2010_cses_4th_company_law_directve_en.pdf

CSES based part of its work on the Consortium's work and on a questionnaire addressed through the European Business Test Panel (EBTP) http://ec.europa.eu/yourvoice/ebtp/index_en.htm . When a policy option leads to potentially removing all administrative costs for a given activity, the potential savings take into account what constitutes only administrative burden. For example, supposing the administrative cost of drawing up an annual report is 100, and assuming that 25% of the companies would prepare such annual report even in the absence of a legal obligation, the administrative burden equals 75.

The savings and population figures for medium sized companies result exclusively from an option to increase the thresholds of 14% throughout the EU. These have been estimated by the Commission services.

Generally, it has been estimated that the savings will reduce the burden on companies rather than the "business as usual" part of administrative costs.