Update on the new EU accounting directives

Transposing the EU acquis communautaire: status and perspectives

Pascal Frèrejacque, World Bank CFRR
EU Financial reporting regimes

- Group - Listed
  - BIG?

- Alone - Unlisted
  - SMALL?

Small sized companies

Medium sized companies

~8000 listed companies

Regulation (CE) n° 1606/2002 = IFRS + MS Options

4th and 7th Accounting Directives transposed in 27 national jurisdictions (national GAAP)

Source: European Commission
Context of the proposed directives: why a change?

» The on-going financial and economic crisis calls for reform to renew growth

» The EU response:
  – Europe 2020: The EU is working to move decisively beyond the crisis and create the conditions for a more competitive economy with higher employment: smart, sustainable, inclusive growth
  – EU better regulation agenda: to lessen the administrative burden of smaller companies to let them focus on business growth and create better conditions for access to finance

» Need for a more consistent reporting framework across the EU, differentiated for companies of different size

» Accounting directives are being revamped to gain in clarity and to level the playing field in EU countries
The EU accounting directives were drafted more than 30 years ago.
Amendments to the directives have added many requirements:
- Disclosures
- Valuation rules, including provision for fair-value accounting
Less attention to simplify or remove existing requirements, including Member State (MS) options that do not favor comparability.
Increased complexity is a burden on smaller companies.
PIE have now their own regime: the IAS Regulation.
SMEs represents 99 per cent of the market.

“Think small first” approach
Objectives for a change to the accounting directives

» Overall Objective: better functioning of the Single Market:
  - Increased access to finance
  - Reduction in the cost of capital (transparency effect)
  - Increase level of cross-border trade
  - Merger and acquisition activity

» By establishing the requirements for limited liability companies to:
  - To have less burden in preparing financial statements
  - Increase clarity and comparability of financial statements within the EU
  - Protection of essential user needs
When preparing the new accounting directive the European Commission changed some of the terminology:

- Company → Undertaking
- Accounts → Financial Statements
- Annual Report → Management reports

These changes were made to align the wording of the new directive with modern accounting language.
Small Companies

<table>
<thead>
<tr>
<th>Small undertakings</th>
<th>Key features of the changes in the new directive</th>
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<tbody>
<tr>
<td>1.1 million undertakings</td>
<td>Maximum harmonization</td>
</tr>
<tr>
<td>21% of the undertakings</td>
<td>Notes to the accounts limited</td>
</tr>
<tr>
<td>New thresholds:</td>
<td>Not requirements for statutory audits</td>
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<tr>
<td>B/S total: EUR 5 million</td>
<td>Small groups exempt from preparing consolidated financial statements</td>
</tr>
<tr>
<td>Net turnover: EUR 10</td>
<td></td>
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<tr>
<td>Employees (average): 50</td>
<td></td>
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</tbody>
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EC to revise periodically the thresholds for determining the auditing and reporting obligations of companies; not a MS decision anymore
A simplified regime for smaller companies

» Introduction of a specific regime for small companies to reduce administrative burden
  - No statutory audit obligations
  - Limited disclosures:
    • Accounting policies
    • Guarantees and commitments not recognized in the balance sheet (more protection for creditors)
    • Post balance sheet event
    • Long term and secured debts
    • Related parts transactions (more protection for creditors)

» In some countries this will results in additional notes requirements because of there will be no MS option to remove these requirements maximum harmonization
## Medium and Large Companies

<table>
<thead>
<tr>
<th>Medium –sized and large undertakings</th>
<th>Key features of the changes in the new directive</th>
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<tbody>
<tr>
<td>0.3 million undertakings</td>
<td>Introduction of a general principles of materiality and substance over form</td>
</tr>
<tr>
<td>4 % of the undertakings</td>
<td>Bottom-up approach to disclosures</td>
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<tr>
<td><strong>New thresholds medium-sized:</strong></td>
<td>Reduction in the number of MS options</td>
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<tr>
<td><strong>B/S total:</strong> EUR 20 million</td>
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<tr>
<td><strong>Net turnover:</strong> EUR 40 million</td>
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<tr>
<td><strong>Employees (average):</strong> 250</td>
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<tr>
<td><strong>Large undertakings</strong> above those thresholds</td>
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</tbody>
</table>
Key elements: main principles

» Fully harmonized regime for the preparation of small undertakings financial statements (no MS option to require further disclosures)

» General principle of materiality introduced allowing combination of line items in the P/L or the B/S, omission of disclosures that are immaterial; the level of materiality is the responsibility of the company

» Requirement to present the economic reality of a transaction in the financial statements and not just its legal form
Key elements: balance sheet and profit and loss account

- Only on balance sheet layout instead of two previously.

- Two profit and loss account layouts instead of four for enhanced comparability:
  - by nature
  - by function

- Removal of extraordinary revenues and expenses
From a MS option approach to an harmonized approach

- All companies under a certain category (small, medium large) will be comparables across the EU
- Bottom-up approach to notes
  - More limited disclosure regime for small companies
  - Additional requirements for medium-sized companies
  - Additional requirements for large companies and PIEs

But new mandatory notes for all companies for which there was a MS option not to report

- Post-balance sheet events
- Related parts transactions including with wholly-owned companies
Regime for PIEs does not depend on size: application of the IAS Regulation 2002/1606

New Accounting Directive:
- Corporate governance statement in the management report is an obligation for PIEs only
- Additional notes for PIEs only:
  - Segment reporting
  - Total audit fees for statutory audit and other assurance services
Not pursued anymore as a policy option
Few difference remain between the new accounting directive and IFRS for SMEs
  - Amortization of the goodwill (5 years in the directive/10 years in IFRS for SMEs)
  - Presentation of unpaid subscribed share

If IFRS for SMEs is not compliant with the acquis requirements there are very few adjustment to be made to that standard to be in compliance with the new directive

Future changes in the IFRS for SMEs could remove the differences (or make them bigger)
The EC has issued a Directive in February 2012 to allow MS to apply a light reporting regime for micro undertakings.

Micro undertakings share two of the following characteristics:
- Less than 10 employees
- Less than .7 million turnover
- Less than .3 million total assets

Obligation to prepare a simplified balance sheet, and a simplified profit and loss account and no notes if information on valuation methods, commitments by way of guarantees, advances and credits granted to or committed by management and transactions on shares.

Simplified accruals for other than cost or raw materials and consumables, value adjustments, staff costs, and tax… and no fair value.

Obligation to file the balance sheet and notes with the register.

No management report.
Changes proposed by the Parliament and Council are numerous and significant, implying possible delays in the publication of the final directive.

If confirmed, those changes would lead to a much lesser degree of harmonization in accounting practices across the EU compared to what was envisaged initially by the Commission.

Examples of options that would be reinstated if the Council's views prevailed include an alternative presentation of the financial statements (referred to as "the UK layout"); the last-in, first-out (LIFO) method to measure inventories; and the capitalization of the so-called formation costs.

The implications for REPARIS countries are not entirely clear although the fact that a number of options might still be offered in the directive would mean that transposition of the directive could be easier since countries would have a range of options to choose from.
Thank you

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