The World Bank Centre for Financial Reporting Reform

REPARIS Road to Europe: Program of Accounting Reform and Institutional Strengthening

Update on the new EU accounting directives

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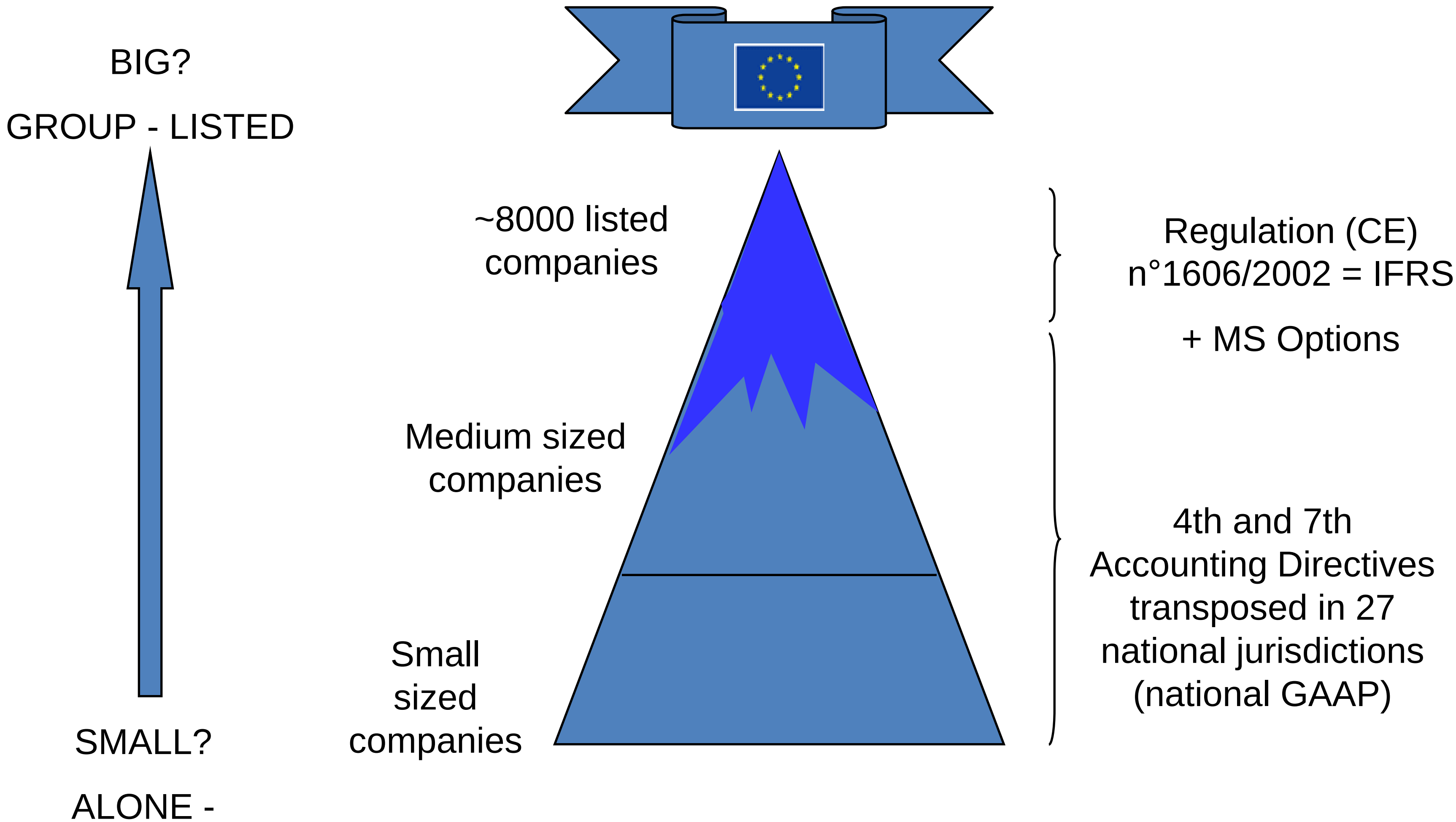
EU Financial reporting regimes



Source: European Commission

Context of the proposed directives: why a change? (i)

- 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 equal conditions in EU countries

Context of the proposed directives: why a change? (ii)

- 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:**
  - Have less burden in preparing financial statements
  - Increase clarity and comparability of financial statements within the EU
  - Protection of essential user needs

Glossary

- 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

Small undertakings	Key features of the changes in the new directive
1.1 million undertakings 21 % of the undertakings **New thresholds:** **B/S total:** EUR 5 million **Net turnover:** EUR 10 **Employees (average):** 50	Maximum harmonization Notes to the accounts – limited in number - five key areas No requirements for statutory audits Small groups exempt from preparing consolidated financial statements

EC to revise periodically the thresholds - to preserve the thresholds' real value over time

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 party transactions (more protection for creditors)
- In some countries this will results in additional notes requirements because there will be no MS option to remove these requirements

→ maximum harmonization

Medium and Large Companies

Medium –sized and large undertakings	Key features of the changes in the new directive
0.3 million undertakings 4 % of the undertakings **New thresholds medium-sized:** **B/S total:** EUR 20 million **Net turnover:** EUR 40 million **Employees (average):** 250 **Large undertakings** above those thresholds	Introduction of a general principles of materiality and substance over form Reduction in the number of MS options

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Key elements: main principles

- More harmonization in disclosures and more comparable disclosure regimes for same types of companies
- 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 one 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

Key elements: Notes to the financial statements

- From a MS option approach to an harmonized approach
  - All companies under a certain category (small, medium large) will be comparable 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 party transactions including with wholly-owned companies

Key elements: disclosures for PIEs

- 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, other assurance services, for tax advisory services and for other non-audit services

IFRS for SMEs

- 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 shares

- IFRS for SMEs - the MS could adopt for all or some unlisted companies **provided that** the Directive was fully implemented and the standard was modified to comply with any accounting requirement of the Directive that departed from the IFRS for SMEs
- Changes/Revisions of the IFRS for SMEs could remove the differences (or make them bigger)

Changes of 2012 - Micro undertakings (i)

- 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, except
    - Commitments by way of guarantee
    - Advances and credits granted to the members of the administrative, managerial and supervisory bodies
    - Acquisitions of own shares

Changes of 2012 - Micro undertakings (ii)

- Simplified accruals for other than cost or raw materials and consumables, value adjustments, staff costs, and tax… and no fair value
- Removal of the obligation to present 'Prepayments and accrued income' and 'Accruals and deferred income‘
- Obligation to file the balance sheet and notes with the register
- No management report

Latest developments

- New compromised text in the EU parliament – April 2013
- Some changes are reinstating the provisions of previous directives (e.g. 2 balance sheet layouts, LIFO method)
- This means - lesser degree of harmonization in accounting practices across the EU compared to what was envisaged initially by the Commission
- The implications for Albania 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

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