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MEMO/11/732

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Financial reporting obligations for limited liability companies – frequently asked questions

1. What does this proposal cover?

As part of the Responsible Business package (see IP/11/1238), the European Commission proposes to make changes to current EU rules for preparing companies' individual and, where relevant, consolidated financial statements with a view to improving the quality of the information disclosed. The proposal would also reduce the administrative burden for small companies.

2. What are the existing EU rules on accounting for limited liability companies?

There has been a Directive in place for individual financial statements since 1978 (78/660/EEC), and one for consolidated financial statements since 1983 (83/349/EEC). These two Directives provide a complete set of rules for the preparation and content of statutory financial statements. They are often referred to as the "Accounting Directives". The Commission proposes to replace these two Directives by a single Directive that is better adapted to the present and future needs of preparers and users of financial statements.

3. What are the main objectives of the proposal?

Unnecessary and disproportionate administrative costs imposed on small companies hamper economic activity and impede growth and employment. The primary objective of the proposal is therefore to simplify the preparation of financial statements for small companies. The proposal also aims to make company financial statements more comparable, clearer and easier to understand. This would allow the users of financial statements, such as shareholders, banks, suppliers and employees to gain a better understanding of the performance and financial position of a company and hence better inform and protect them. The proposal foresees maximum harmonisation as far as the accounting obligations of small companies (as defined in the Directive) are concerned.

4. Why now?

During the past 30 years, amendments to the Accounting Directives have added many requirements, such as new disclosures and valuation rules (including detailed provisions on fair value accounting). This has not only made the rules more complex and increased the regulatory burden for companies, but also sometimes made financial statements less comparable across the EU. The impact of these new requirements has been greatest on small and medium-sized companies, which are the backbone of the European economy and the main job creators in the EU.

5. What is the relationship of this proposal with the Commission's 2009 proposal on accounting requirements for micro-entities?

The two proposals are complementary. The 2009 proposal (see IP/09/328) on the financial statements of micro-entities, is currently being negotiated by the EU's Council of Ministers and the European Parliament. As they have now both agreed to the principle of a micro-entity regime, the current proposal does not contain any new policy proposals regarding micro-companies. The Commission is willing to consider, together with the Council and Parliament, how best to integrate the final inter-institutional agreement on micro-entities into the proposed new Accounting Directive.

6. How would companies benefit?

The Commission is proposing to revise the current requirements by thinking "small first". This would lead to a “mini-regime”, in which all EU small companies were be able to prepare a simpler profit and loss account, balance sheet and a limited number of accompanying notes which would provide further narrative information on the financial position of the company. This would significantly reduce the administrative burden for these companies. Thinking "small first" also means that the disclosure requirements for medium-sized and large companies would become more gradual – they would be need to be proportionate to the size of the company and the information needs of financial statement users. There would also be an increase in the company size thresholds for small and medium-sized companies, meaning that more companies would fall into these categories, and these thresholds would be harmonised across the EU which would also result in more companies qualifying as small and medium-sized. There would also no longer be an EU requirement for small companies to have an audit.

The proposal would improve the clarity and comparability for all EU companies' financial statements, leading to increased access to cross-border trading opportunities and funding.

7. What would be the potential cost savings?

It is estimated that 1.1 million small companies would collectively save around €1.5 billion per year, and that 0.2 million medium-sized companies would save €0.2 billion per year.

8. In which member States would the effects be the most significant?

The benefits of a simpler "mini-regime" for small companies and increasing threholds would be most evident in Bulgaria, Cyprus, the Czech Republic, Estonia, Finland, France, Greece, Hungary, Ireland, Latvia, Lithuania, Poland, Portugal, Romania, Spain, Sweden and Slovakia, as until now these Member States have had limited simplifications for small companies.

More companies would qualify as small companies, as a result of harmonising company size thresholds in Belgium, Cyprus, Greece, Finland, Ireland, Latvia, Malta, Romania and Sweden. For the first time, a category of medium-sized company would be recognised in Belgium, Bulgaria, the Czech Republic, Estonia, Greece, Finland, France, Hungary, Italy, Lithuania, Poland, Portugal, Romania, Slovakia and Sweden. This would result in more companies being considered as medium-sized instead of large in these Member States. In addition, as the net turnover and total assets thresholds would also be uprated in line with inflation since they were last increased in 2006, more companies would be categorised as small in all the other Member States, and some large companies that currently exceed the thresholds only marginally would be re-categorised as medium-sized in the Member States where this category has already been recognised in national law (Austria, Cyprus, Germany, Denmark, Spain, Ireland, Luxemburg, Malta, The Netherlands, Slovenia and the United Kingdom).

Abolishing the EU audit requirement for small companies, together with the increase in small company size thresholds, would take more companies out of the EU scope of audit in Austria, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Greece, Finland, France, Hungary, Ireland, Lithuania, Latvia, Malta, Poland, Portugal, Spain, Sweden and Slovakia.

The comparability and clarity of financial statements would be improved as a result of applying the principle of "substance over form" to all companies in Austria, Belgium, Denmark, France, Latvia, Sweden, Slovakia and Slovenia.

9. Why would small groups be exempted from preparing consolidated financial statements?

Requiring the parent company of a small group to prepare consolidated financial statements, in addition to its individual financial statements, adds a considerable administrative burden. This is especially the case when only a small number of users is interested in the performance and financial position of a small group.

In fact, most Member States have already adopted an option into their national legislation that exempts small groups from preparing consolidated financial statements. Only Estonia, Greece and Romania do not currently use this exemption.

10. Why merge the Directives on individual and consolidated financial statements?

There are many cross-references between the two Directives, so merging the two is a logical step. Furthermore, in the public consultation on the review of the Directives, there was strong support for such a measure on the grounds that it would provide clarity, consistency and coherence to the accounting framework for non-listed companies. The current Directives date from 1978 and 1983 respectively and in any event need to be modernised and simplified.

12. Is action at European level really necessary? After all most SMEs do not even operate cross-border.

It is true that most EU micro-entities have limited cross-border activity, and because of this the Commission proposed, back in 2009, to give Member States the option of exempting them from the Accounting Directives (see IP/09/328). However, as companies become larger they are more likely to look to expand cross-border. Having a more harmonised accounting regime within the EU would facilitate that process.

Accounting requirements impose a disproportionate burden on small companies suffer , as they have limited resources to deal with administrative formalities.This proposal would create a more proportionate accounting regime for small businesses in the EU, in which the requirement to provide accounting information was balanced with the essential needs of users of accounting information.

13. Would this not lead to fragmentation of the Single Market?

On the contrary, this proposal would strengthen the cohesiveness of the Single Market. By making financial statements more comparable, clearer and easier to understand, cross-border activity would be facilitated and this would allow companies to find further funding outside their home Member States. The simplified regime for the smallest companies (micro-entities) would not have much impact on the Single Market, given that these firms generally operate at a very local level.

14. How are IFRS and IFRS for SMEs linked to this proposal?

IFRS (the International Financial Reporting Standard) for small and medium enterprises was published by the International Accounting Standards Board[1] in 2009 in order to meet the specific accounting needs of SMEs. When examining the various policy options available to replace the existing Accounting Directives, the Commission examined and rejected the option to adopt the IFRS for SMEs at EU level. The Impact Assessment concluded that introducing the IFRS for SMEs would not appropriately serve the objectives of simplification and reduction of administrative burden. For instance, the Directive does not require that a cash flow statement be prepared, whereas this is mandatory under the IFRS for SMEs.

Nevertheless, the Member States would be able to adopt the IFRS for SMEs as their accounting standard for all or some of their 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.

15. The Commission announced a few months ago that it would bring forward a legislative initiative on a common consolidated corporate tax base [CCCTB]. How does this proposal fit with this initiative?

The harmonisation proposed under the CCCTB (see IP/11/319) would only involve the computation of the tax base and would not impact the preparation of financial statements. Therefore, Member States would maintain their national rules on financial reporting as derived from the Directive, and the CCCTB system would introduce autonomous rules for computing the tax base of companies. The CCCTB rules would not affect the preparation of individual or consolidated financial statements.

[1] Based in London, the International Accounting Standards Board or IASB is an independent, not-for-profit private sector organisation working in the public interest. It is responsible for developing the International Financial Reporting Standards International Accounting Standards and promoting the use and application of these standards

16. Why would the proposal not introduce electronic filing tools such as XBRL?

When preparing the proposal, the Commission considered whether to mandate the preparation of financial statements under an electronic format such as XBRL[2].

Whilst it is still worth considering a broader use of XBRL in the EU, it appears neither necessary, nor proportionate at this stage to mandate the adoption of XBRL or similar formats since the conditions to ensure that companies will reap the full benefits of such a form of reporting are not in place in each Member State.

17. Why prevent public interest entities (PIEs) from the benefit of any simplification?

PIEs (typically listed companies, banks and insurers) take money from the public at large, and there needs to be a high degree of transparency around their performance and financial position to allow fully informed decisions to be taken by members of the public before dealing with such an entity. Accordingly, the simplified and reduced accounting requirements for small and medium-sized privately-owned companies are considered inappropriate for PIEs.

18. What about "Banking" and "Insurance" Accounting Directives? Why are they not in the package?

The banking and insurance accounting Directives build on the principles of the original Accounting Directives, introducing specific requirements for the financial statements of banks and insurance companies. The changes being proposed would, therefore, have an effect on the accounting formats used by banks and insurance companies. The proposed legislation includes a correlation table that would allow users of the "banking" and "insurance" Directives to identify specific changes which would have consequential effects on these two Directives. This would also be the case for other Directives that cross-reference to the original Accounting Directives.

The Commission does not propose at this stage a general revision of the "banking" and "insurance" accounting Directives.

More information:

http://ec.europa.eu/internal_market/accounting/sme_accounting/index_en.htm

See MEMO/11/730, MEMO/11/734 and MEMO/11/735

IP/11/1238

[2] XBRL stands for "extensible Business Reporting Language" and is a freely available, market-driven, open, and global standard for exchanging business information.