THE CONSEQUENCES OF THE NEW EU ACCOUNTING DIRECTIVE ON FINANCIAL REPORTING

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ABSTRACT

The objective of this paper is to analyse the EU accounting related legislation as a consequence of the introduction of the new European Directive, i.e. Directive 34 of the EC, changing the 4th and the 7th Directive of the EU.

These accounting updates will mostly be of the technical and accounting type and will particularly be directed at the financial statements of different sized companies.

Therefore, in light of these recent developments, we have herein focused on the current accounting system applied in the EU, which comprises the IAS/IFRS standards and the existing national regulations and is changed by the implementation of the EEC accounting directives.

KEY WORDS: European Directives, accounting systems, annual financial statements

1.INTRODUCTION

The globalisation of the markets and the increased commercial relations and exchanges, the enhanced mobility of the workforce, of capital and commodities, have led to the need for a financial harmonisation of financial reporting on an international level, in order to ensure the higher transparency and comparability of the accounting documents and, subsequently, to a more efficient functioning of the capital market[5]. Evidence also suggests that the European accounting Directives (the 4th and the 7th Directive) applied by EU states have not contributed to a more satisfying level of accounting harmonisation. These circumstances have urged the EU to adopt the International Accounting Standards (IAS), renamed the International Financial Reporting Standards (IFRS) since 2002, issued by the IASB (International Accounting Standard Board) and to modernise the accounting directives[2],[3].

The reason why the Directive 2013/34/EU has been introduced was to simplify the information provided by financial reporting, depending on the size of the reporting company.

2.THE CHANGES INTRODUCED BY THE DIRECTIVE 2013/34/EU OF THE EEC

The new EC Directive includes the regulations introduced on a European level and concerning the adequate preparation of the financial statements, of the consolidated financial statements and of other economic and financial information that should be reported. This directive abolishes the EU accounting directives related to annual and consolidated accounts, namely: Directive 78/660/EEC and 83/349/EEC (art.52). The new directive must be adopted by the member states by July 20th 2015 (art.53).

Objectives of Directive 34

The objectives of the new directive are[1]:

a) To provide common and coherent rules that can be applied to financial statements with the purpose of:
    1) Improving the comparability and transparency of financial statements
    2) Protecting the interests and demands of the financial statements users;
    3) Facilitating cross-border investment
b) To simplify and harmonise the accounting regulations for small undertakings in order to avoid situations when these may be burdened with excessive administrative obligations.

Scope

According to the provisions of this directive, its scope covers:

a) Limited liability companies and limited partnerships with share capital;
b) Partnerships, limited partnerships, unlimited companies, if the direct or indirect members are members of the undertakings of the type listed in a).
c) Limited partnerships, if the partners actually have limited liability due to other undertakings of the type listed in a) and b).

The scope of the present Directive excludes non-profit undertakings.

Categories of undertakings

Directive 4 identifies 4 types of undertakings, namely[2]:

a) Micro-undertakings (new category, optional)
b) Small undertakings (already present, mandatory category)
c) Medium-sized undertakings (already present, mandatory category)
d) Large undertakings (already present, mandatory category)

The definition and the scope of the 4 categories of undertakings was based on:

- Quantitative parameters
- Qualitative parameters

Table no. 1 – Categories of undertakings

Categories of undertakings (at least 2 out of 3 should be met)	Micro-undertakings	Small undertakings	Medium-sized undertakings	Large undertakings
Balance sheet total	≤ 350.000	≤ 4.000.000*	≤ 20.000.000	> 20.000.000
Net turnover	≤ 700.000	≤ 8.000.000*	≤ 40.000.000	> 40.000.000
Nr. of employees throughout the financial year	≤ 10	≤ 50	≤ 250	≤ 250

* EU member states may define thresholds that shall not exceed 6.000.000 for the balance sheet total and 12.000.000 for the net turnover

The new Directive introduces the definition of "public interest entities" (art. 2), as well as undertakings that are under the scope according to Article 1 (public limited companies or associated undertakings whose unlimited responsibility associates are all public limited companies), such as: listed companies, credit institutions, insurance undertakings, other undertakings created in the member states. The Public Interest Entity (PIE) must be considered a large undertaking, regardless of its balance sheet total, net turnover or average number of employees (art.40).The Member States believe it is best to apply a distinct accounting framework, simplified for micro-undertakings[6]. Where no specific regulations for micro-undertakings are provided, the rules for small undertakings will apply. Investment undertakings and participating interest undertakings must be exempt from the advantages of the simplification regime applied to micro-undertakings[6].

The Directive 34/2013 of the EEC provides certain alternative measures for the Member States, namely[1]:

- adopting the abridged versions of the balance sheet and profit and loss account for small and medium sized undertakings (abridged Balance Sheet and Profit and loss account);
- adopting a limited Financial statement regime for micro-undertakings and small undertakings;
- exemption of small undertakings from the mandatory draw up of the Management Reports;
- imposing the obligation for undertakings to be audited (certified);
- requiring medium-sized and large undertakings to provide additional information apart from what the Directive provides;
- requiring medium-sized and large undertakings to draw up other financial statements apart from the Balance sheet, the profit and loss account and the notes to the financial statements;

The new Directive defines the "group" as consisting of the parent undertaking and all its subsidiary undertakings. The Directive identifies 3 categories of groups, namely: small groups, medium-sized groups and large groups [4]. The definition and scope of the above mentioned groups was based on:

- quantitative parameters (measured in aggregated value)
- qualitative parameters

Table no. 2 – Group categories

Group category (at least 2 out of 3 should be met)	Small groups	Medium-sized groups	Large groups	
Balance sheet total	≤ 4.000.000*	≤ 20.000.000	> 20.000.000	
Net turnover	≤ 8.000.000*	≤ 40.000.000	> 40.000.000	
Nr. of employees throughout the financial year	≤ 50*	≤ 250	≤ 250	

* EU member states may define thresholds that shall not exceed 6.000.000 for the balance sheet total and 12.000.000 for the net turnover

The new Directive exempts small groups from the obligation to draw up consolidated financial statements, except where any affiliated undertaking is a public interest entity (art.23).Directive 34/EEC of 2013 also provides additional circumstances for the member states to exempt medium-sized groups from the obligation to draw up consolidated financial statements, except where any affiliated undertaking is a public interest entity (art.23).According to Directive 34/2013 of the EEC, it is mandatory to apply:

- the going concern principle; moreover, Member States can exempt undertaking from this principle;

- the consistency principle; member states can limit the scope of this principle (in terms of presentation and disclosures);
- the materiality and aggregation principle; Member States can exempt undertaking from the scope of this principle.

Accounting principles

Directive 34/2013 provides that the member states should apply the fair value criterion for measurement of (art.8):

a) Financial instruments, including financial derivative financial instruments
b) The assets of the various financial instruments

The fair value measurement cannot be applied to:

a) The non-derivate financial instruments held to maturity;
b) Loans and receivables originated by the undertaking and not held for trading purposes.

The application of these criteria can only be limited in the case of consolidated financial statements. The fair value criterion applied o financial instruments is based on one of the following values:

a) the market value, in the case of financial instruments for which a reliable market can readily be identified or the market value of a similar instrument;
b) the value resulting from generally accepted valuation models and techniques, as they allow for he reasonable approximation of the market value;
c) the purchase price principle or the production cost where he a) and b) methods do not apply.

Structure of the financial statements

1. *The Balance Sheet* = the "research expenses" category has been excluded from the intangible assets section of the balance sheet.

2. *The profit and loss account*

- the extraordinary section of the profit and loss account has been eliminated;
- the nature and the financial effect of the components of the significant revenues for the respective sums or percentages (for small undertakings as well).

3. *The notes to the financial statements*

According to Directive 34/2013 of the EEC, it is recommended:

- a "layered" approach with the obligation of additional information in relation to the increase in size of the undertaking;
- a set of mandatory information for all categories of undertakings (art.16);
- the recommendation for the member states to ask small undertakings for certain "further" information (e.g. agreements outside the balance sheet, significant events occurring after the balance sheet has been closed, operations between parties, correlated movements of fixed assets) – mandatory for medium-sized and large undertakings.

Table no. 3 Typology of the information provided in Directive 34/2013 of the EEC

Art.	**Typology of the information provided in Directive 34/2013/EEC**	**Small undertakings**	**Medium-sized undertakings**	**Large undertakings**	**PIE**
16.1a)	Applied accounting principles	X	X	X	X
16.1b)	Relevant fixed assets (e.g. dynamics of the revaluation reserve)	X	X	X	X
16.1c)	Financial instruments or assets other than financial instruments measured at fair value (e.g. dynamics of the fair value reserve)	X	X	X	X
16.1d)	Financial commitments, guarantees or contingencies that are not included in the balance sheet (e.g. their nature and value)	X	X	X	X
16.1e)	Advances and credits granted to members of the administrative, managerial and supervisory bodies (e.g. interest rates and value)	X	X	X	X
16.1f)	The amount and nature of items of income or expenditure which are exceptional in size or incidence	X	X	X	X
16.1g)	Debt analysis (e.g. due after more than five years)	X	X	X	X
16.1h)	Number of employees	X	X	X	X
16.2 – 17.1a)	Fixed assets (e.g. variations, purchase price)	(X)	X	X	X
16.2 – 17.1m)	Name and registered office of the undertaking which draws up the consolidated financial statement of the smallest body of undertakings of which the undertaking forms part as a subsidiary	(X)	X	X	X

	undertaking				
16.2 – 17.1p)	Agreements included in the balance sheet	(X)	X	X	X
16.2 – 17.1q)	Significant material events arising after the balance sheet date	(X)	X	X	X
16.2 – 17.1r)	Transactions with related parties	(X)	X	X	X

X – mandatory information
(X) – mandatory information when required by a member state

Art.	**Typology of the information provided in the new directive**	**Small undertakings**	**Medium-sized undertakings**	**Large undertakings**	**PIE**
17.1b)	Value and reasons for taxation adjustments operated in the balance sheet categories		X	X	X
17.1c)	Financial instruments measured at purchase price or production cost (e.g. at fair value)		X	X	X
17.1d)	Emoulments granted to the members of the administrative, managerial and supervisory bodies		X	X	X
17.1e)	Number of employees broken down by category		X	X	X
17.1f)	Deferred assets and taxes (balances and movements)		X	X	X
17.1g)	He list of the participating interest in controlled or related undertakings		X	X	X
17.1h)	The number and the nominal value of the shares subscribed during the financial year		X	X	X
17.1i)	Where there is more than one class of shares, the number and the nominal value for each class		X	X	X
17.1j)	The existence of any participation certificates, convertible debentures, warrants, options or similar securities or rights, with an indication of their number and the rights they confer		X	X	X
17.1k)	The name, the head or registered office and the legal form of each of the undertakings of which the undertaking is a member having unlimited liability		X	X	X
17.1l)	The name and registered office of the undertaking which draws up the consolidated financial statement of the largest body of undertakings of which the undertaking forms part as a subsidiary undertaking		X	X	X
17.1n)	The place where copies of the consolidated financial statements referred to in points l. and m. can be obtained		X	X	X
17.10)	The appropriation of the profit or treatment of loss for the current financial year		X	X	X
18.1a)	The net turnover broken down by categories of activities and into geographical markets			X	X
18.1b)	The total fees charged (e.g. by audit firms)			X	X

Exemptions for micro-undertakings

The member states can exempt micro-undertakings from any or all of the following obligations: (art.36):

- the obligation to publish the balance sheet, so that the balance sheet can be submitted to the assigned competent body;
- the drawing up of the notes to the financial statements, that would include information referring to: i) the purchase of their own shares; ii) loans and credits granted to the members of the administrative and supervisory bodies and iii) obligations resulting from contracting any type of warranty
- the preparation of the management report that presents information on the purchase of their own shares.

Exemptions for micro-undertakings:

- member states may permit micro-undertakings to draw up an abridged balance sheet and Profit and loss account;
- micro-undertakings benefitting from the above mentioned exemptions can resort to the fair value measurement method.(Art.8)
- investment undertakings and financial undertakings cannot be exempt from the simplified methods.

Publication of the balance sheet
The Member States shall ensure that undertakings publish within a reasonable period of time which shall not exceed 12 months after the balance sheet date:

- the balance sheet and the management report, accompanied by the statutory Auditor's Report
- the consolidated Balance Sheet and the consolidated Management Report, accompanied by the Auditor's Report.

Publication of the Balance Sheet
Member States can exempt small undertakings from the obligation to publish their Profit and loss account and the notes to the financial statements, member States can permit medium-sized undertakings to publish the abridged versions of the Balance Sheet and of the notes to the financial statement, member States ensure that the members of the administrative, management and supervisory bodies are collectively responsible for the drawing up and publication of simple and consolidated financial statements according to the obligations provide in the current directive.
Auditing the financial statements
The Member States ensure that the simple and the consolidated Financial Statements are subject to auditing:

- of Public Interest Entities;
- of medium-sized and large undertakings.

The financial audit is conducted by one or several statutory auditors or audit firms approved by Member States. Auditors or audit firms must:

  - express an opinion on (i) whether the management report is consistent with the financial statements, (ii) whether the management report has been prepared in compliance with the applicable legal requirements.
  - state whether the management reports contain any misstatements and provide an indication on the nature of such misstatements.
  - the Member States may decide whether to impose the obligation of financial auditing for micro-undertakings.

Auditing the Financial Statements
Article 35 of the Directive 34/2013/EEC, changing Article 28 of the Directive 2006/48/EC (Audit Directive), provides that the audit report on the auditing of simple and consolidated financial statements should include:

- an introductory paragraph which shall, as a minimum, identify the financial statements that are subject to the statutory audit, as well as the financial reporting framework that has been applied in their preparation;
- a description of the auditing standards based on which the statutory audit was conducted;
- an opinion on the financial statements, either unqualified, qualified or adverse, that would state clearly the opinion of the statutory auditor as to:
  - whether the financial statements provide a true and fair view in accordance with the relevant financial reporting framework;
  - where appropriate, whether the financial statements comply with the statutory requirements.

If the auditor is unable to express an opinion on the financial statements, the report must contain a disclaimer of opinion :

- reference to any matter on which the statutory auditor draws attention, for the users of the financial statements, without qualifying the audit opinion in the Audit Report.
- issue an opinion on the coherence of the financial statements.

The Audit Reports can be combined when the financial statements of the parent undertaking are attached to the consolidated financial statements.

3. CONCLUSIONS

The introduction of the new European Directive may be regarded as a step forward for the financial reporting of European Union business entities, since it will clearly lead to: the simplification of the standards that will in turn lead to the significant reduction of the administrative costs, especially in the case of smaller size undertakings; the updating and modernisation of the contents of the directives, in order to develop a clearer and more comparable structure of the financial statements of companies, with specific focus on undertakings that develop their activities on an international level and have a greater number of stakeholders.

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