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Part I

EXECUTIVE SUMMARY OF THE 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

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EXECUTIVE SUMMARY

The Accounting Directives (hereafter the "Directives")[1] deal with the annual and consolidated financial statements of limited liability companies in Europe. During the past 30 years, amendments to these Directives have tended to pay insufficient attention to the comparability and user friendliness of the financial statements and have gradually increased complexity and the regulatory burden for companies, especially for the smaller ones.

This impact assessment presents the Commission's proposal to modernise and simplify the financial reporting requirements of EU limited liability companies so as to make them less burdensome and more suited to users' needs.

1. PROBLEM DEFINITION

1.1. What are the main problems

The preparation of financial statements has been identified as one of the most burdensome regulatory obligations for companies[2].

Consultations and analysis indicate that micro / small companies face higher administrative burdens in comparison to medium-sized / large companies. Where a big enterprise spends one Euro *per employee* to comply with a regulatory duty, a medium-sized enterprise might spend four Euros and a small business up to ten Euros per employee.

The financial statements are often not the main source of information used by stakeholders in smaller entities. Yet, the Directives require the smaller companies to prepare extensive financial statements and to comply with a number of other requirements, thus preventing the Member States from designing simpler local solutions. Smaller companies have to prepare financial statements to a level of detail suitable only to larger companies. This is especially the case for the requirements to disclose extensive information in the notes to the financial statements. In addition, with the absence of a general principle of materiality from the Directives, trivial information can be presented in the financial statements for no other reason than complying with regulatory requirements.

Due to the current flexibility offered to Member States in defining company size, companies that are considered as small under the Directives are categorised as medium-sized or even large under national rules in many Member States. This affects the ability of EU companies to compete on a level playing field.

Finally, there are around 80 significant options in the Directive on annual accounts that Member States may adopt or not, and about 40 options in the Directive on

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[1] Fourth Council Directive of 25 July 1978 on the annual accounts of certain types of companies (78/660/EEC), Seventh Council Directive of 13 June 1983 on consolidated accounts (83/349/EEC)

[2] http://ec.europa.eu/enterprise/policies/better-regulation/administrative-burdens/priority-areas/index_en.htm

consolidated accounts. Options generally relate to presentation, recognition, measurement and disclosure in financial statements, and to the overarching "substance over form" principle. This creates problems for users of the financial statements, increasing with company size (medium-sized / large), due to the lack of clarity and comparability this entails for financial reporting across the Member States. It can prevent optimal cross border investment decisions, and results in increased burden for companies with cross border subsidiaries.

1.2. What are the drivers of the problems?

The Directives are one key driver. EU companies also face further local financial reporting requirements, such as tax and statistical reporting, due to national regulations.

1.3. Impact of the microeconomic problems on the macro level

The unnecessary and disproportionate administrative cost imposed on small companies hampers economic activity and is an impediment to growth and employment.

1.4. How big is the problem?

Around 7.3 million companies are within the scope of the Directives, of which 1.1 million are small. It is estimated that the total costs for small companies of complying with the requirements of the Directives amounts to €3.1bn annually, of which €1.7bn constitutes a potential administrative burden.

1.5. Subsidiarity

There is a need to act at EU level, given that the main drivers are the EU Directives. The preferred policy options should be limited to what is necessary in order to attain the objectives and be proportionate.

2. OBJECTIVES

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

3. POLICY OPTIONS

In order to meet the objectives set out above the Commission services have identified and considered a number of policy options, first, through an examination of the broad policy options and second, within the context of the preferred broad approach, through an examination of a subset of options for the revision of the Directives. The options examined in this document should be seen as complementary to the 2009 proposal published on 26 February 2009 aiming to allow the Member States to relieve micro entities from EU level accounting obligations[3].

3.1. Broad policy options for reducing administrative burden and increasing the effectiveness, relevance and understandability of financial reporting.

Comparing to the baseline scenario (no change), the range of broad policy options and choice of legal instruments includes the following:

(1) Baseline scenario (no change);

(2) Better use of existing options in the Directives by Member States;

(3) Revision and modernisation of selected requirements currently in the Directives in order to reduce administrative burdens on companies in the EU, particularly for SMEs;

(4) Creating a wholly new EU accounting framework and adopting the "International Financial Reporting Standards for SMEs" for mandatory use within the EU;

(5) Repealing the Directives and allowing the Member States to put in place whatever basic accounting regime they choose for unlisted companies.

Having compared the broad policy options above, the preferred option is option 3 consisting in a revision of selected requirements currently in the Accounting Directives through a new Directive replacing the existing Fourth and Seventh Council Directives. This is justified as the most reasonable option to achieve the objectives, having regard to the necessity and proportionality of EU legislation, the timeline, and its acceptability to stakeholders.

3.2. Comparison of options within a review of the Directives

Various options can be considered within the frame of a review of the existing Directives:

Options with an overall reach

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

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

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

[3] 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 10 employees, as well as certain limits for the balance sheet total and net turnover.

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; 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.

The table below provides an overview of the analysis of the above 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*						

Comparing the options above to the baseline scenario, the Commission services have identified that options 1, 2, 4, 5 and 8 are worth pursuing. These options are not mutually exclusive and have been preferred in view of the objectives mentioned above, the potential impacts, and the potential for general acceptance by stakeholders. These preferred options also fit with the "think small first" approach supported by the European Commission.

4. ANALYSIS OF MAIN IMPACTS

4.1.1. *Companies*

The preferred options would provide savings up to a maximum of €1.7bn per year on a recurring basis. The main beneficiaries of this burden reduction would be small companies (around €1.5bn) as a result of a regime that would limit disclosures, harmonise company size definition across the EU, and clarify that the Directives no longer require a statutory audit or consolidation of small groups.

The revision could also have effects on micro-companies. However these savings would be equally 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.

Other benefits expected for companies remaining include the increased clarity of financial statements through clearer principles, and a better comparability stemming from a reduced number of options, especially for medium-sized and large companies.

4.1.2. *Users of financial reporting*

For small companies, key information needs of creditors would be kept, or even increased in some Member States as disclosures of "Guarantees and commitments, contingencies, arrangements" and "Related party transactions" would become mandatory for this category of company.

A positive impact on the information provided to the users of financial statements of small, medium-sized and large companies can be expected due to a strongly improved comparability of the financial statements as well as enhanced clarity based on harmonised principles.

4.1.3. *Public authorities*

The revision should have no budgetary consequences for public authorities.

4.1.4. *Macro-economic and single market*

Cutting "red tape" for smaller companies should contribute to the creation of a business climate that encourages company formation and entrepreneurship, and frees up resources of existing companies that can be reallocated towards productive uses. Fewer options, increasing comparability of the financial statements of larger companies and a focus on information that is really useful in decision-making can result in better investment decisions and a better allocation of capital, thus facilitating cross-border investment, trade and competition.

4.1.5. *Third countries and international relations*

The project would improve competitiveness of small EU businesses vis-à-vis companies from other jurisdictions. Better comparability and clarity of the financial statements of EU companies could in addition make the EU more attractive to foreign capital and entrepreneurs.

4.1.6. Social Impacts

A business climate that encourages company formation and entrepreneurship, as well as permitting a re-allocation of resources to operations, should be more favourable to jobs creation than it is today.

5. MONITORING AND EVALUATION

A detailed monitoring plan will be part of the overall monitoring strategy in relation to the general revision of the Directives.

The evaluation will include an assessment of whether the key objectives have been met, and also possibly allow for further lessons to be learnt.