

FINANCIAL REPORTING LEGISLATION IN THE EU

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THREE PARTS

- 15.15-15.45
Annual accounts (4th Directive)
- *15.45 Coffee break*
- 16.00-16.30
Consolidated accounts (7th Directive)
- 16.30-17.00
IAS Regulation - International Financial Reporting Standards

Accounting Directives

Fourth Company Law Directive – (78/660/EEC)

- Audited annual accounts
- “True and fair “ view of company’s assets, liabilities, financial position, profit and loss

Seventh Company Law Directive – (83/349/EEC)

- Consolidated accounts

Eleventh Directive – (89/666/EEC) – PRESENTED EARLIER TODAY

- Disclosure requirements of branches

Sector-specific Directives for banking (86/635/EEC) and insurance (91/674/EEC) – ALREADY DISCUSSED (CH. 9) – NOT COVERED TODAY

Several modernisations/updates of the Directives

European Commission 
Internal Market & Services DG

Accounting Directive are...

- difficult to transpose into law – but much more complicated to make work in practice
- full of sensitive political compromises (tendency to avoid reopening issues...)
- reflect accounting thinking at the time they were written
- at a crossroad... (*I come back to this later on*)

Accounting Directives

Good: high basic level of accounting,
respected national traditions

Less Good : many options,
comparability / consistency
difficult
rules not suitable for
international companies in
global capital markets

PART 1: ANNUAL ACCOUNTS

4th Directive (1978)
with subsequent amendments etc.

4th Directive – starting point

- One of the world's most successful accounting texts!
- Combines "Anglosaxon" and continental accounting traditions
- Preparations started in 1960's, redirection when the UK joined 1973
- Difficult negotiations – many options

4th Dir. – Scope, “True and Fair”

- “The annual accounts shall comprise a balance sheet, the profit and loss account and notes to the accounts.”
- “The annual accounts shall give a true and fair view...”
 - If not: additional information or non-application of rules (“override”)

4th Dir. - Layouts

- Standardised formats with possibility for additions
- 2 possible layouts for each statement - best practice
- Further options in 2003/51: allow for "current – non-current balance sheet" and "performance statement"

4th Dir. - Valuation rules

- Historical cost (purchase cost or production cost)
- *Inflation accounting, replacement values?*
- *Market value (Banks' Accounts Directive)*
- *Current value (Insurance Accounts Directive)*
- Fair value – included through 2001/65

4th Dir. – Annual report, Auditing and publication

- Contents of annual report (extended through 2001/65 and 2003/51)
- Disclosures (May 2006 amendments off-balance sheet transactions, internal control structures etc.)
- Publication of accounts (still controversial...)
- Auditing requirement

4th Dir. – SME's

- Simplifications for small and medium-sized companies
- Changed 2 May 2006:
 - Small (Article 11):
total balance sheet EUR 4.400.000
net turnover EUR 7.300.000
50 empl.
 - Medium-sized (Article 27): total balance sheet EUR 17.500.000
net turnover EUR 35.000.000
250 empl.

PART 2: CONSOLIDATED ACCOUNTS

7th Directive (1983)
with subsequent amendments etc.

7th Dir. – main rules

- When consolidated accounts must be established (legal versus control approach)
- True and fair approach
- Layouts and valuation – as in 4th Directive
- Uniform valuation methods in the group
- Consolidation techniques
- Participating interest (4th Dir.) vs. associated undertaking (7th Dir.)
- Publication, auditing, cf. 4th Directive.

7th Dir. – Recent amendments

- 2001/65 – Valuation at fair value
- 2003/65 – Adjustment to scope of consolidation, contents annual report
- May 2006: Disclosure of off-balance sheet items, disclosure of internal control and risk management structures

PART 3: INTERNATIONAL ACCOUNTING CONVERGENCE... and the future

**International Accounting Standards/International Financial
Reporting Standards**

IAS Regulation (2002), applied from 2005

New developments in the 90's

- The Accounting Directives worked well, but...
- Introduction of the euro
- Globalization of capital markets/
consolidation of stock exchanges
- IOSCO work on harmonised requirements for
stock exchanges
- More focus on the standard-setting work in the
IASB
- Directives not detailed enough, not properly
maintained

IAS Regulation (1606/2002/EC)

- Directly applicable in all MS
- Fast , no national variations
- All EU companies listed in the EU to use endorsed IAS for consolidated accounts as from 2005
- Non-EU issuers outside the scope
- Optional extension of the scope: (in fact used by few MS)
 - unlisted companies
 - individual accounts

The IAS Regulation (EC/1606/2002)

- Regulation – directly applicable in all Member States
- No need for national rules transposing EU law
- Less time consuming, no national variations



Scope of the IAS Regulation

- Requirement: EU companies listed in the EU to use endorsed IAS for consolidated accounts
- Non-EU issuers outside the scope
- Optional extension of the scope:
 - unlisted companies
 - individual accounts
 - e.g. banks and insurance companies

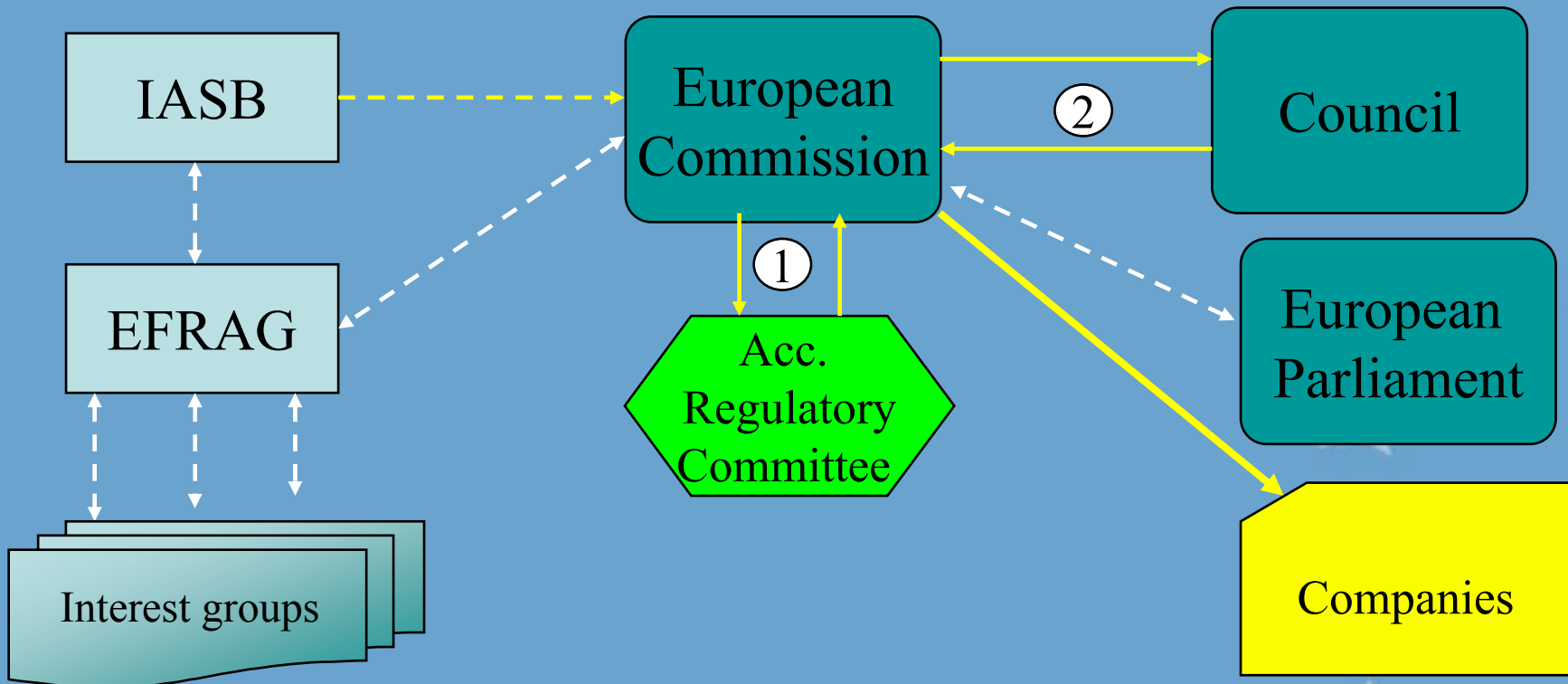
Endorsement

- Objective:
 - Political and legal endorsement of IAS into EU law
 - pro-active device for the shaping of future standards
- Endorsement infrastructure:
 - Position of the EU within the IASCF structure
 - EFRAG (European Financial Reporting Advisory Group)
 - EU Accounting Regulatory Committee
 - Commission
 - European Parliament

Endorsement criteria

- IAS not contrary to the "true and fair view" principle of the 4th and 7th Accounting Directives
- IAS must be conducive to the European public good (competitiveness and convergence)
- IAS meet the criteria of understandability, relevance, reliability and comparability

IAS Endorsement process



← - - - -> Consultation ① Normal case scenario
← - - - -> decision making ② additional decision making



Endorsement of existing IAS

- All existing IAS, except some provisions of IAS 39 have been endorsed
 - The controversy about IAS 39: certain provisions related to hedge accounting and the full fair value option were carved out
- Adopted IAS published in full in all official languages of the Community in the Official Journal
- Consolidation project

Fitting IAS/IFRS into the existing legal framework

- Company Law Directives
 - 4, 7 Directives on accounting
 - 2nd Directive on profit distribution
- The IAS Regulation "overrides" the Directives for companies in its scope
 - MS can extend the scope of regulation
 - If MS use IFRS to inspire national law for other companies, these must be in line with the Directives
- Even if a MS requires IFRS by all companies, the Directives must be implemented
 - Provisions not included in IFRS – only those?
 - Part of a legal framework

The future, in particular for non-listed companies

- IAS/IFRS elaborated for large, listed companies
- The Directives apply
- Lack of maintenance of Directives and national GAAPs
- Role of the Directives in the future
- IASB work showing the way also for small company accounting? "Drop down"?
- Pressure to simplify SME accounting
- Likely revision of the Accounting Directives (2007 or 2008?)

Contacts

Commission web-site

http://europa.eu.int/comm/internal_market/en/index.htm

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