



Implementing the New European Accounting Directive: Making the right choices

Facilitated by EFAA in association with ACCA and NBA, Brussels 14 July 2014



On 14 July 2014, EFAA (European Federation of Accountants and Auditors for SMEs), in association with ACCA (the Association of Chartered Certified Accountants) and NBA (Nederlandse Beroepsorganisatie van Accountants), organized a roundtable discussion in Brussels entitled “**Implementing the New European Accounting Directive: Making the right choices**”.

Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, the so-called Accounting Directive, was published on 26 June 2013 and entered into force on 20 July 2013. It replaces the existing Fourth and Seventh Company Law Directives that addressed reporting by companies generally and by groups. It represents the culmination of a significant amount of debate on the accounting acquis in Europe and incorporates some 100 Member State Options (“MSOs”). The implementation period is now approaching its deadline and Member States are required to transpose the Directive into their national law by 20 July 2015.

The implementation phase can be both considered as a challenge but also as an opportunity to get things right while reassessing the current accounting regime in place in the various Member States. The determination of which MSOs to use raises some interesting and sometimes complicated questions. To address them, EFAA, with the support of ACCA and NBA organised a brainstorming roundtable in Brussels to discuss, with experts from the Member States, regulators, the European Commission, SME organisations, the banking and the accounting/auditing sectors, what MSOs should be taken on board and what criteria should be used to determine their inclusion.

The debate revealed that some stakeholders are not convinced that MSOs left within the Accounting Directive would either enhance the “level playing field” or increase comparability across Europe, but that they, on the contrary, would create a challenge for Member States who now must implement the Directive. The discussions also revolved around the need for Member States to consider what the aim is that they wish to pursue. Is it better accounting – and then what does constitute better accounting - or is it seeking reductions in costs and so-called administrative burden above all? It was of value in particular to consider what roles transparency and market efficiency, comparability, relevance, costs versus benefit and international harmonization play in this process, and what should be the appropriate criteria.

Some participants agreed that better accounting should be the right objective when choosing options but questioned whether the Directive itself had considered this.

Of particular interest to participants was the issue regarding the audit requirement for smaller companies. Small companies under the previous directives could be exempted from the general



audit requirement as a MSO but in the new Directive there is a requirement for the audit only of medium and large companies. It is clear that Member States can nevertheless choose to require the audit for small companies. National circumstances will need to be considered, including the impact of any increase in the size thresholds which may increase substantially the number of companies otherwise falling out of the audit requirement. Participants expressed significant concern that Member States think carefully about the decisions they take in this regard. Some participants expressed concerns that any significant reduction in the number of entities that would be required to have a statutory audit could have severe consequences for the economies of those Member States and the single market. They noted that audit can play a significant part in furthering trade between companies within the single market (by enabling access to finance and trade credit), providing an important part of the foundations of a strong economy, promoting the growth of businesses and employment, facilitating the transfer of ownership of businesses so enabling the continuance of small business and employment, ensuring that appropriate amounts of direct and indirect taxes are collected and preventing and detecting money laundering, bribery and corruption. Other participants noted that even where the national law did not require an audit companies should carefully consider what would be of value for them and that in some circumstances they should undertake to have a voluntary audit if they were to seek to improve their overall internal control or to access external funding.

The issue of international harmonization was discussed at length. Whilst it was noted that this might not have been on the agenda for European legislators participants felt it important to stress that 47% of all SMEs are internationally active. Financial institutions and access to finance is significantly affected by global developments. Opinions were expressed that choosing options that would not conflict with IFRS for SMEs had great merit. Moving towards an international framework could have positive consequences for market efficiency. IFRS for SMEs or some form of alignment to IFRS for SMEs could be seen as a “nice to have”. In addition it was noted that Member States should be alert to the fact that they might ultimately end up requiring different information to be disclosed in their companies’ financial statements than that which is required by very close neighboring Member States. This alone could have repercussions for trading due to the close proximity of competitor companies. Some of these companies might be disadvantaged.

Lastly, there was general agreement that one of the most important considerations should be that financial statements provide information that is relevant to users. This might mean that in certain cases and certain Member States SME financial statements should be subject to a statutory audit. This should mean that options are considered using the better accounting criteria put forward above and that we should recognize the call of some participants that the speed at which financial statements are ultimately published is increased. Timelier information is often better information for users and the current deadline of 12 months might be too long.

Main highlights

- **Bodo Richardt**, EFAA President, noted that some believe that the MSOs neither enhance the “level playing field” nor increase comparability across Europe. Instead they create a challenge for Member States who now must implement the Directive and in doing so must determine which options to use. However, they also create an opportunity.
- The determination of which MSOs to use raises some interesting questions. *What constitutes better accounting? What roles do transparency and market efficiency, comparability, relevance, costs versus benefit and international harmonization play in this process? What are the appropriate criteria?*
- Arguably one of the most topical MSO is the inclusion within the Directive of the Micro Directive. This Micro Directive is incorporated as Chapter 9 (Provisions concerning



exemptions and restrictions on exemptions) and Article 36 (Exemptions for micro-undertakings) and these rules are already in effect within certain Member States who have decided to adopt this MSO. What actions will those who have not already adopted this Micro Directive now take? Is it a relief of administrative burden or will it compromise better accounting for smaller entities?

- In order to facilitate better accounting in the EU, there is a need for further intelligent discussions, considering other views, and getting feedback based on facts and not political gut feelings. The debate revealed a strong need for more evidence on certain multifaceted issues before making any final decisions. Platforms to discuss complex accounting issues that deliver recommendations are very important because the political decision making process itself is complex. However, rationality and practicality are very important ingredients, especially for SMEs.
- **Richard Martin**, Head of Corporate Reporting, ACCA, moderated the discussion. He reminded the roundtable that the Accounting Directive must be used by companies by 1 January 2016 at the latest.
- In respect of the content of the Directive, he noted that many people felt that the changes implemented were relatively restrictive highlighting however that the country by country reporting is clearly a major change and will be part of the implementation.
- Another change that will have a big impact is the existence of MSOs and majority of these affect SMEs. This is an important moment for accounting in Europe. Each Member State has to assess what options to use. Some options are current options in the Fourth and Seventh Directives, while others are new, introduced with the new text.
- However, even if the option is an existing one, new legislation has triggered a debate about whether we got the law right before, or if there are any amendments that should be made in order to improve the existing regime. There are indeed several changes that Member States have to consider because of the replacement of the law.
- **Henk Verhoek**, Coordinator Financial Reporting, NBA, spoke about *the Options within the Directive, the criteria for making the right choices, and the new MSOs*. “The extent of the MSOs could reduce comparability and consistency across Europe. One of the objectives might have been to harmonize the accounting in the EU so that we move towards one accounting language. Unfortunately, this might not be the outcome of the political process.
- New and already existing options give rise to a great opportunity to reassess the application of existing options in the law of the Member States. The Member States have now to evaluate whether the right choices have been made in the past. Amendments might need to be made. In order to make the right decisions, the criteria of *better accounting* should be used. The use of “better accounting” as a determinant of which MSOs to adopt might help create something that comes close to a “level playing field” in Europe.
- Not everything is included in the new Directive. Soft law is yet to be added, and it is an important task for national standard setters to cover other areas, for example, lease or pensions accounting.
- *International harmonization* and IFRS for SMEs have not been embraced by the EU. IFRS for SMEs will stay relevant for internationally operating companies and hence it could be very important not to choose options that would obstruct the implementation of IFRS for SMEs. Opinions are divided whether IFRS for SMEs fulfill this criterion but one significant advantage of IFRS for SMEs is the fact that it is more or less all inclusive.
- In order to fulfill the *better accounting* criteria, information should be valuable to users. Protection of investors’ and creditors’ rights is an important aspect. Quality in accounting stimulates economic growth in the EU and makes access to finance simpler.



- *Transparency and market efficiency are other important criteria.* Maximum harmonization has been introduced for small entities and it is forbidden for Member States to require more information to the financial statements. Some disclosures are no longer required but are instead left as MSOs. These are very important disclosures and include the disclosure of significant post balance sheet events, movements on reserves including dividends, components of changes in tangible fixed assets, details of subsidiaries and associates, identify of the parent undertaking, related party transactions and off balance arrangements.
- *Comparability is* also an important element of the new Directive particularly with respect to the internationalization of banking systems.
- In respect of the *relevance* criterion, it is essential to fulfill user needs and to provide quality information. The majority of all undertakings are small companies, and it is good to see that the “think small first” principle is embedded within the new Directive.
- The period allowed for publication of the financial information is 12 months in the Directive and this is considered to be too long because the value of information can very often be linked to how timely that information is. EFAA’s quick poll on filing deadlines carried out in April/May 2013 suggested that a shorter period of 7 months be considered. The nearer the publication date to the balance sheet date, the more valuable the information provided to users will be.
- **Claus Securs**, President of the German Chamber of Public Accountants, spoke about *the Micro Directive, Implementation in Member States, Pros and Cons, what factors need to be considered? What challenges are there to appropriate implementation?*
- Mr. Securs noted that there is no obligation to transpose the new Directive into national law and in addition that there was therefore no deadline for the transposition. The objective of the Directive was a reduction of administrative burden for micro-entities with regard to the preparation and publication requirements. Micro-entities were previously subject to the same financial reporting requirements as other small undertakings but it was believed that this placed a disproportionate burden on them.
- A company meets the qualifying conditions to be a micro-entity if it meets at least two out of three of the following thresholds on its balance sheet date: turnover: not more than € 700,000; balance sheet total: not more than € 350,000; average number of employees: not more than 10. Full transposition of the Micro Directive in Germany has affected approximately 500,000 micro-entities. It was effective as of December 31, 2012, and the estimated cost-saving potential per micro-entity is only around € 70 per annum. Of note is the fact that the exemption from the need to recognise accruals and prepayments of “other charges“ was not used as it was not considered to reduce the complexity of accounts preparation.
- Some advantages stemming from using this MSO were noted as: a reduction in time and costs achieved by the elimination of notes, a reduction in the complexity of the balance sheet and income statement and less information need to be provided to competitors, employees and regulators.
- Some disadvantages stemming from using this MSO were noted as fewer than expected cost savings as the need to maintain books and records for micro-entities still persists and the marginal cost of preparing financial statements was not significant and a loss of significant information provided in the financial statements by micro-entities to users and a lack of comparability of micro-entity financial statement.

The EFAA report “Implementing the New European Accounting Directive - Making the right choices” formed the basis of this discussion - <http://www.efaa.com/Reports,Studies,36.html>