



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 17.4.2008  
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2008/0084 (COD)

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Council Directives 78/660/EEC and 83/349/EEC as regards certain disclosure requirements for medium-sized companies and obligation to draw up consolidated accounts**

(presented by the Commission)

{SEC(2008) 466}  
{SEC(2008) 467}

## **EXPLANATORY MEMORANDUM**

### **1. CONTEXT OF THE PROPOSAL**

#### **1.1. Objectives of the proposal**

The objective of the amendment to the Directive 78/660/EEC (4<sup>th</sup> Company Law Directive)<sup>1</sup> is to simplify financial reporting for small and medium-sized companies (SMEs)<sup>2</sup> and relieve SMEs from financial reporting burden in a short term perspective. The changes should lead to reduced administrative burden without loss of relevant information.

The objective of the amendment to the Directive 83/349/EEC (7<sup>th</sup> Company Law Directive)<sup>3</sup> is to clarify the interaction between consolidation rules in this Directive and in the International Financial Reporting Standards.

#### **1.2. General context**

The European Council of 8-9 March 2007 underlined that reducing administrative burden is important for boosting the European economy, especially considering the potential benefits this can bring for SMEs. It stressed that a strong joint effort of the European Union and the Member States is necessary to reduce administrative burden within the EU<sup>4</sup>. At its meeting in March 2008, the European Council called on the Commission to identify new "fast track" legislative proposals in order to reduce administrative burdens<sup>5</sup>. Accounting and auditing have been identified as key areas for reducing administrative burden for European companies<sup>6</sup>. The Accounting Directives are in this context understood as Directives 78/660/EEC and 83/349/EEC.

The proposed amendment forms part of the second fast track package for the reduction of administrative burden<sup>7</sup> which includes legislative measures in the areas of company law, accounting and auditing aiming at simplifying the business environment for European companies; it represents targeted and limited changes that should lead to simplification in the short term perspective. Small and medium-sized companies are often subject to the same rules as larger companies, but their specific accounting needs have rarely been assessed and extensive reporting rules create a cost burden and can hinder efficient use of capital for productive purposes.

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<sup>1</sup> OJ L 222, 14.8.1978, p. 11. Directive as last amended by Directive 2006/46/EC of the European Parliament and of the Council (OJ L 224, 16.8.2006, p. 1).

<sup>2</sup> Definitions in Article 11 (small companies) and Article 27 (medium-sized companies) of the 4<sup>th</sup> Company Law Directive.

<sup>3</sup> OJ L 193, 18.7.1983, p. 1, Directive as last amended by Council Directive 2006/99/EC (OJ L 363, 20.12.2006, p. 137).

<sup>4</sup> Presidency Conclusions of the Brussels European Council - doc. 7224/07, Conclusion 1.

<sup>5</sup> Presidency Conclusions of the Brussels European Council – doc. 7652/08, Conclusion 1.

<sup>6</sup> EU Project on baseline measurement and reduction of administrative costs, Second interim report, 15 January 2008, page 37. Final report will be published on the Commission website.

<sup>7</sup> See Commission working document "Reducing administrative burdens in the European Union 2007 progress report and 2008 outlook" - SEC(2008) 35.

The 4<sup>th</sup> Company Law Directive was adopted in 1978 in order to create a harmonised set of requirements for the external reporting of all limited liability companies in the EU. In 1983, the 7<sup>th</sup> Company Law Directive was adopted and added a common set of requirements for consolidated financial statements. During the past 25 years the Accounting Directives have been modified several times. Through the adoption of the Regulation (EC) No 1606/2002 on the application of international accounting standards (IAS Regulation)<sup>8</sup> listed companies (and those with listed debt) have to present IFRS accounts, and are consequently relieved from most of the requirements in the 4<sup>th</sup> and 7<sup>th</sup> Directives. These Directives however still form the basis for SME accounting in the EU.

The application of the IAS Regulation has also highlighted the borderline between the Directives and IFRS. Directive 83/349/EEC requires a parent company to prepare consolidated accounts even if the only subsidiary or all of the subsidiaries as a whole are not material. As a consequence these companies are scoped in the IAS Regulation and therefore have to prepare their consolidated financial statements in accordance with IFRS. This consequence of the particular Article in Directive 83/349/EEC is considered to be excessive where a parent company has only immaterial subsidiaries. Such cases should be looked into and efficient solutions be found.

Also the European Parliament encourages “the Commission to continue its activities with regard to the simplification of company law, accounting and auditing..., in particular the 4<sup>th</sup> and 7<sup>th</sup> Company Law Directives”<sup>9</sup>.

## **2. RESULTS OF CONSULTATIONS OF INTERESTED PARTIES AND IMPACT ASSESSMENT**

### **2.1. Consultation of interested parties**

#### *2.1.1. The simplification proposals concerning the 4<sup>th</sup> Company Law Directive*

The Commission Services conducted research in order to identify the potentially most burdensome requirements of the Accounting Directives<sup>10</sup>. The initial findings indicated that several amendments could be made in order to simplify them.

These initial ideas and suggestions were discussed with Member States in the Accounting Regulatory Committee (ARC) at several meetings from December 2006 onwards. Following these discussions, the Commission published a Communication

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<sup>8</sup> Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (OJ L 243, 11.9.2002, p. 1).

<sup>9</sup> Report on International Financial Reporting Standards (IFRS) and the Governance of the International Accounting Standards Board (IASB) (2006/2248(INI)), EP, Committee on Economic and Monetary Affairs, Rapporteur: Alexander Radwan, A6-0032/2008, 5.2.2008, p. 10.

<sup>10</sup> Including the study conducted by Ramboll Management, commissioned by the Commission: Study on Administrative Costs of the EU Company Law Acquis, July 2007, available on the Commission website:  
[http://ec.europa.eu/internal\\_market/company/docs/simplification/final\\_report\\_company\\_law\\_administrative\\_costs\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/simplification/final_report_company_law_administrative_costs_en.pdf)

in July 2007<sup>11</sup> identifying potential amendments/changes to the Accounting Directives. Special attention was given to finding further relief for reporting by small and medium-sized companies. The Commission Services identified policy options to be considered and from these possible options selected for legislative action after a public consultation the following legislative measures.

#### Removal of disclosure requirement for formation expenses

A clear majority of respondents to the Commission's Communication supported the proposal. A small number of respondents argued that the specific disclosure concerned provided useful information.

#### Removal of disclosure requirements for breakdown of turnover into activity and geographical markets for SMEs

This proposal was supported by almost three quarters of those who responded to the Commission Communication, whilst a quarter was against. Certain commentators found the proposal useful for SMEs, but not for the other companies in the scope of the 4<sup>th</sup> Company Law Directive.

#### *2.1.2. The interaction between consolidation rules in the 7<sup>th</sup> Company Law Directive and International Financial Reporting Standards*

Various discussions with Member States and constituents have shown that the relationship between the IAS Regulation and the 7<sup>th</sup> Company Law Directive is not clear in cases where parent companies have no material subsidiaries. Following the discussion with Member States, the Commission Services included this issue in its above mentioned Communication, as it is linked to simplification, and proposed to clarify the situation through an amendment to the 7<sup>th</sup> Company Law Directive.

The respondents were strongly in favour of such a proposal, with companies being unanimously positive. Commentators regarded the proposed change as substantial simplification.

## **2.2. Impact assessment**

### *2.2.1. Removal of disclosure requirement for formation expenses*

All Member States except Denmark, Sweden, UK allow formation expenses to be capitalised and require the disclosure of such expenses<sup>12</sup>. Companies in the scope of Article 11 (defining small companies) of the 4th Company Law Directive can already be exempted from this disclosure requirement according to Article 44 (2) of the same Directive. This exemption has been widely used, and only Spain requires this disclosure as a separate item of small companies. Some Member States require however disclosure as intangible fixed assets. The effect of the proposed change

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<sup>11</sup> Communication from the Commission on a simplified business environment for companies in the areas of company law, accounting and auditing - COM(2007) 394, 10.7.2007. Available on the Commission website: [http://ec.europa.eu/internal\\_market/company/simplification/index\\_en.htm](http://ec.europa.eu/internal_market/company/simplification/index_en.htm)

<sup>12</sup> Report: Implementation of the Fourth Directive in Member States as per 1 January 1998, pages 2, 38, 62. Available on DG MARKT's website at: [http://ec.europa.eu/internal\\_market/accounting/docs/studies/1998-fourth-dir\\_en.pdf](http://ec.europa.eu/internal_market/accounting/docs/studies/1998-fourth-dir_en.pdf).

affects therefore mainly medium-sized companies. According to a study prepared by Ramboll Management there are approximately 240,000 medium-sized companies in the EU<sup>13</sup>.

The change leads to a reduction of reporting burden for companies. There is no significant loss of information for users of accounts. Information on formation expenses cannot be considered very relevant for users. Both preparers and users benefit from the proposal. Other stakeholders are basically not affected.

### *2.2.2. Removal of disclosure requirements for breakdown of turnover into activity and geographical markets for SMEs*

All Member States require disclosure of the breakdown of turnover into activity and geographical markets<sup>14</sup>. The possibility granted by Article 44 (2) of the 4th Company Law Directive to exempt Article 11 (small) companies from this requirement has been used by all Member States. The effect of the proposed change affects therefore medium-sized companies. The Commission Services assess that Member States will make use of the proposed change, despite the fact that the minimum legislative nature of the Directive would allow them to require more information.

Removal of this requirement enables companies to structure their internal reporting according to management needs, rather than financial reporting requirements. The change leads to a reduced reporting burden for companies. There is no significant loss of information for users of accounts. Users of accounts of SMEs and other companies in the scope of the Directive do not particularly request this kind of information. It could also disclose certain information considered confidential for companies with only one line of business. Both preparers and users benefit from the proposal. Certain stakeholders with particular interest in this information may be affected, but this effect is considered limited.

### *2.2.3. Amendment to the 7th Company Law Directive in order to clarify the relationship of its consolidation rules with the rules of International Financial Reporting Standards*

The problem seems to be very specific, and concentrated to some larger Member States. Smaller Member States seem to be less affected mainly due to the smaller number of listed groups. Furthermore certain Member States have not enforced the preparation of such accounts, but may be inclined to do so after the clarification given in discussions in the Accounting Regulatory Committee during 2007. In

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<sup>13</sup> Ramboll Management. July 2007. Study on administrative costs of EU Company Law Acquis. Available on DG MARKT's website at: [http://ec.europa.eu/internal\\_market/company/docs/simplification/final\\_report\\_company\\_law\\_administrative\\_costs\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/simplification/final_report_company_law_administrative_costs_en.pdf).

<sup>14</sup> Implementation of the Fourth Directive in Member States, Summary of findings from a study on the implementation of Fourth Directive 78/660/EEC in the Member States of the European Union, As per 1 January 1998, EC, Internal Market DG, Financial services – Financial information and company law (see note nr. 10), p. 54, 59.

particular in the UK and in France there seem to be a number of cases where the preparation of such accounts causes problems<sup>15</sup>.

The preparation of these accounts entails significant costs without corresponding benefits to the company. These accounts also need to be audited, which entails additional large costs. Under normal circumstances there is no loss of information as these consolidated accounts are virtually identical to the individual accounts. There may however be very few individual cases where a certain loss of information could occur. The Commission Services assess this loss of information as insignificant. The winners are parent companies with immaterial subsidiaries that have to prepare consolidated accounts.

### **2.3. Monitoring and evaluation**

This proposal should be seen in connection with other simplification measures and their impact shall be evaluated together. This proposal represents only a first part of the simplification exercise in accounting. The efficiency of the proposed measures should be monitored in future steps of the simplification process and, if needed, further changes can be suggested in a forthcoming revision.

## **3. LEGAL ELEMENTS OF THE PROPOSAL**

### **3.1. Legal basis**

Article 44(1) of the Treaty establishing European Community<sup>16</sup>.

### **3.2. Subsidiarity and proportionality principles**

This proposal does not fall under the exclusive competence of the Community. Action at EU level is necessary with a view to dealing with these problems to the extent that obligations entailing administrative burdens derive from EU directives. The objective of the action is the reduction of administrative burden by simplifying financial reporting for SMEs in a short-term perspective and clarifying the interaction between consolidation rules in Directive 83/349/EEC and IFRS without loss of relevant information and clarification of the interaction between rules in the 7<sup>th</sup> Company Law Directive and International Financial Reporting Standards.

The proposal continues the Community's principle based approach to EU-Accounting regulation. Also, the Accounting Directives represent "minimum harmonisation"<sup>17</sup>. This ensures proportionality and leaves flexibility to authorities and economic operators on how to fulfil the objectives while minimising their financial and administrative burden. Furthermore, an analysis of national legislation should ideally take place and further simplification measures at national level might be recommendable.

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<sup>15</sup> According to data provided by the UK, there are 1.6m active limited liability companies in UK, with 51 000 forming groups out of which only 10000 provide consolidated accounts. It was identified that 1 000 groups provide consolidated accounts while having only non-material subsidiaries.

<sup>16</sup> OJ C 325, 24.12.2002, p. 35.

<sup>17</sup> Member States can put in place more extensive requirements nationally. The Directives already contain numerous options for SMEs, but many of those have not been taken up by Member States.

The objective can only be achieved through the modification of the relevant EU rules; action at EU level is therefore justified. The proposed modifications are limited to what is necessary in order to remove the unnecessary administrative burdens in the areas concerned and are proportionate to this objective.

### **3.3. Choice of instrument**

The proposed instrument amends existing directives and is therefore a directive.

## **4. EXPLANATION OF THE PROPOSAL**

### *4.1.1. Removal of disclosure requirement for formation expenses*

Formation expenses are different types of costs related to the creation of a company. For example, registration fees or legal assistance costs. These can under some circumstances be treated as an asset in the balance sheet. If this is the case, Article 34(2) of the 4<sup>th</sup> Company Law Directive requires that these “formation expenses” are explained in the notes to the accounts. Small companies can be exempted from this disclosure requirement in accordance with Article 44(2) of the same Directive.

The Commission suggests extending the scope of these exemptions also to include medium-sized companies. Accordingly, the Commission proposes in Article 44(2) of the 4<sup>th</sup> Company Law Directive to add medium sized companies within the context of Article 44(2) of this Directive and extending so the discretion of Member States to relieve these companies from the obligation imposed by Article 34(2).

### *4.1.2. Removal of disclosure requirements for breakdown of turnover into activity and geographical markets for SMEs*

The 4<sup>th</sup> Company Law Directive requires that a breakdown of turnover into activity and geographical markets is disclosed. This is required for all companies, but small companies can be excluded in accordance with Article 44(2) of the same Directive.

The Commission suggests extending the scope of these exemptions also to include medium-sized companies. Accordingly, the Commission proposes in Article 44(1) of the 4<sup>th</sup> Company Law Directive to add medium sized companies within the context of Article 43(1)(8) of this Directive and extending so the discretion of Member States to relieve these companies from the obligation imposed by Article 43(1)(8).

### *4.1.3. Amendment to the 7<sup>th</sup> Company Law Directive in order to clarify the relationship of its consolidation rules with the rules of International Financial Reporting Standards*

The relationship between the IAS Regulation and the 7<sup>th</sup> Company Law Directive is not clear in cases where parent companies have no material subsidiaries. The problematic issue is whether such a parent company would fall under the IAS Regulation – and therefore have to prepare IFRS accounts – or not.

The Commission considers it excessive to require the preparation of consolidated accounts in the situation where a parent company has only immaterial subsidiaries. It is unreasonable to require a separate set of accounts as the consolidated accounts

would be - in this scenario - quasi identical to the individual accounts (which do not fall mandatorily into the IFRS regime following the IAS regulation).

Accordingly, the Commission proposes in Article 13 of the 7<sup>th</sup> Company Law Directive to add a new paragraph 2a which would exempt any parent undertaking governed by its national law from the obligation to draw up consolidated accounts and consolidated annual report if this parent undertaking has only subsidiary undertakings considered as not material (for the purposes of Article 16(3)), both individually or as a whole.

## **5. BUDGET IMPLICATIONS**

There are none for the Community budget.

Proposal for a

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Council Directives 78/660/EEC and 83/349/EEC as regards certain disclosure requirements for medium-sized companies and obligation to draw up consolidated accounts**

**(Text with EEA relevance)**

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 44(1) thereof,

Having regard to the proposal from the Commission<sup>18</sup>,

Having regard to the opinion of the European Economic and Social Committee<sup>19</sup>,

Acting in accordance with the procedure laid down in Article 251 of the Treaty<sup>20</sup>,

Whereas:

- (1) In its Conclusions, the European Council of 8 and 9 March 2007 underlined that reducing administrative burden is important for boosting the European economy, especially considering the benefits this could bring for small and medium-sized companies. It stressed that a strong joint effort of the European Union and the Member States is necessary to reduce administrative burdens.
- (2) Accounting and auditing have been identified as an area for reducing administrative burden for companies within the Community.
- (3) The Commission Communication on 10 July 2007<sup>21</sup> on a simplified business environment for companies in the areas of company law, accounting and auditing identifies necessary amendments to Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies<sup>22</sup> and Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts<sup>23</sup>. Special attention was given to finding further relief from reporting by small and medium-sized companies.

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<sup>18</sup> OJ C [...] [...], p.[...]

<sup>19</sup> OJ C [...] [...], p.[...]

<sup>20</sup> OJ C [...] [...], p.[...]

<sup>21</sup> COM(2007) 394, 10.7.2007.

<sup>22</sup> OJ L 222, 17.8.1978, p. 11. Directive as last amended by Directive 2006/99/EC (OJ L 363, 20.12.2006, p. 137)

<sup>23</sup> OJ L 193, 18.7.1983, p. 1. Directive as last amended by Directive 2006/99/EC.

- (4) In the past, a number of changes have been made in order to enable companies falling within the scope of Directives 78/660/EEC and 83/349/EEC to use accounting methods in accordance with International Financial Reporting Standards (IFRS). Pursuant to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards<sup>24</sup> companies whose securities are admitted to trading on a regulated market of any Member State have to prepare their consolidated accounts in accordance with IFRS, and are consequently relieved from most of the requirements in Directives 78/660/EEC and 83/349/EEC. Those Directives, however, still form the basis for small and medium-sized companies' accounting in the Community.
- (5) Small and medium-sized companies are often subject to the same rules as larger companies, but their specific accounting needs have rarely been assessed. In particular the increasing number of disclosure requirements raises concerns for such companies. Extensive reporting rules create a financial burden and can hinder efficient use of capital for productive purposes.
- (6) The application of Regulation (EC) No 1606/2002 has also highlighted the need to clarify the relationship between the accounting standards required by Directive 83/349/EEC and IFRS.
- (7) Where formation expenses can be treated as an asset in the balance sheet, Article 34(2) of Directive 78/660/EEC requires that those expenses are explained in the notes to the accounts. Small companies can be exempted from this disclosure requirement in accordance with Article 44(2) of that Directive. In order to reduce the unnecessary administrative burden, it should be possible to exempt also medium-sized companies from these disclosures.
- (8) Directive 78/660/EEC requires that a breakdown of turnover into activity and geographical markets is disclosed. This is required for all companies, but small companies can be excluded in accordance with Article 44(2) of that Directive. In order to reduce the unnecessary administrative burden, it should be possible to exempt also medium-sized companies from this disclosure requirement.
- (9) Directive 83/349/EEC requires a parent company to prepare consolidated accounts even if the only subsidiary or all of the subsidiaries as a whole are not material for the purposes of Article 16(3) of Directive 83/349/EEC. As a consequence these companies fall under Regulation (EC) No 1606/2002 and therefore have to prepare consolidated financial statements in accordance with IFRS. This requirement is considered to be burdensome where a parent company has only immaterial subsidiaries. Therefore it should be possible to exempt a parent undertaking from the obligation to draw up consolidated accounts and a consolidated annual report if that parent undertaking has only subsidiary undertakings considered as not material, both individually or as a whole.
- (10) Since the objectives of this Directive, namely reducing administrative burdens relating to certain disclosure requirements for medium-sized companies and the obligation to draw up consolidated accounts for certain companies within the Community, cannot

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<sup>24</sup> OJ L 243, 11.9.2002, p. 1.

be sufficiently achieved by Member States and can therefore, by reason of the scale and effects, be better achieved at Community level, the Community may adopt measures in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve those objectives.

- (11) Directives 78/660/EEC and 83/349/EEC should therefore be amended accordingly,

HAVE ADOPTED THIS DIRECTIVE:

*Article 1*  
*Amendments to Directive 78/660/EEC*

Article 44 of Directive 78/660/EEC is amended as follows:

1. The following paragraph 1a is inserted:

“(1a) Member States may permit the companies referred to in Article 27 to draw up abridged notes on their accounts without the information required in Article 43(1)(8).”

2. The following paragraph 2a is inserted:

“(2a) Member States may permit the companies referred to in Article 27 to be exempted from the obligation to disclose in the notes on their accounts the information prescribed in Article 34(2).”

*Article 2*  
*Amendment to Directive 83/349/EEC*

In Article 13 of Directive 83/349/EEC the following paragraph 2a is inserted:

”(2a) Without prejudice to Articles 4(2) and Articles 5 and 6, any parent undertaking governed by the national law of a Member State which only has subsidiary undertakings which are not material for the purposes of Article 16(3), both individually or as a whole, shall be exempted from the obligation imposed in Article 1(1).”

*Article 3*  
*Transposition*

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 30 April 2010 at the latest. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

*Article 4*  
*Entry into force*

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

*Article 5*  
*Addressees*

This Directive is addressed to the Member States.

Done at Brussels,

*For the European Parliament*  
*The President*

*For the Council*  
*The President*