



**ACCOUNTANCY  
EUROPE.**

**VIEWS**



# **EU BUSINESS INSOLVENCY. A CONTRIBUTION FROM THE ACCOUNTANCY PROFESSION**

**BRIEFING PAPER**

**CORPORATE GOVERNANCE  
& SUSTAINABILITY**

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## HIGHLIGHTS

This paper provides an overview of accountants' and auditors' current contribution to insolvency proceedings in Europe based on the experience of our 50 Member Bodies. This is in support of the proposed EC Directive for an effective insolvency framework which signalled the role of insolvency practitioners, including the accountancy profession. Preventing insolvency or granting second chances to "honest" entrepreneurs who do not make it the first time around, improves the business environment and stimulates growth and jobs.

We also present our recommendations for improving insolvency proceedings in Europe to stimulate the discussion with the Member States and the European Parliament:

- involve practitioners with specialised expertise
- reduce the length of insolvency proceedings
- improve awareness on help available
- encourage management's role in financial distress

Therefore, we welcome any feedback you have on this paper.

## BACKGROUND

In March 2014, the European Commission (the Commission) issued a Recommendation on a new approach to business failure and insolvency, and its implementation in Member States<sup>1</sup>. The objective of this Recommendation was to ensure that viable enterprises in financial difficulties in Europe would have access to national insolvency frameworks, enabling them to restructure at an early stage and preventing their insolvency. The Recommendation also aimed at giving “honest<sup>2</sup>” bankrupt entrepreneurs a second chance across the European Union (EU).

In September 2015, the Commission conducted an evaluation of the implementation of its Recommendation<sup>3</sup>. The Commission concluded that the Recommendation has not triggered the desired impact in facilitating the rescue of businesses in financial difficulty and in giving a second chance to entrepreneurs. The main reason for that was attributed to partial implementation in several Member States, including those having launched reforms. According to the Commission’s evaluation, these differences in implementation mean continuing legal uncertainty, additional costs for investors in assessing their risks, and continuing barriers to the efficient restructuring of viable companies in the EU, including cross-border enterprise groups.

As a follow-up to the Commission Recommendation of 2014 on a new approach on business failure and insolvency and in line with the 2015 Capital Markets Union action plan<sup>4</sup>, the Commission has launched a proposed Directive in order to address certain aspects of substantive insolvency laws. In its proposal, the Commission is also touching upon the role of insolvency practitioners and their professional background, as well as, how they can contribute further to early warning mechanisms and provide a second chance to “honest” entrepreneurs.

## INTRODUCTION

In light of the EU legislative initiative on Business Insolvency, Accountancy Europe, building on the daily experience of its members from 50 professional bodies across the EU and beyond, has decided to look into the current application of insolvency proceedings in order to better reflect what the overall involvement of the profession is. In addition, we consider what could be improved when it comes to contributing further to rescuing and restructuring viable businesses or facilitating insolvency regimes in Europe.

The information included in this publication was collected via an internal survey (the survey) run through the member bodies of Accountancy Europe. The survey was carried out by a questionnaire filled out by Accountancy Europe’s members on a best endeavours basis; no scientific sampling or other method was followed. Therefore, this publication does not intend to provide for an in-depth representation of the profession’s involvement in each EU Member State, but to give indications of trends and practices that should prove useful to further inform the public policy debate. The collected information has been used to reach key conclusions on the profession’s contributions to insolvency proceedings in Europe overall.

The objective of this publication is to better identify the role of professional accountants in insolvency proceedings in Europe and to propose suggestions on how accountants and auditors can offer their expertise to enhance early warning and re-structuring mechanisms or provide a second chance to “honest” entrepreneurs.

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<sup>1</sup> [http://ec.europa.eu/justice/civil/files/insolvency/01\\_insolvency\\_recommendation\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency/01_insolvency_recommendation_en.pdf)

<sup>2</sup> The Commission does not provide any definition of an “honest” entrepreneur.

<sup>3</sup> [http://ec.europa.eu/justice/civil/files/insolvency/02\\_evaluation\\_insolvency\\_recommendation\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency/02_evaluation_insolvency_recommendation_en.pdf)

<sup>4</sup> “Convergence of insolvency and restructuring proceedings would facilitate greater legal certainty for cross-border investors and encourage the timely restructuring of viable companies in financial distress.”

[http://ec.europa.eu/justice/civil/files/insolvency/01a\\_action\\_plan\\_cmu\\_en.pdf](http://ec.europa.eu/justice/civil/files/insolvency/01a_action_plan_cmu_en.pdf)

## KEY QUESTIONS TO IDENTIFY THE PROFESSION'S ROLE

In this section, we will provide an overview of the profession's current contribution to insolvency proceedings in Europe. The purpose is to look into:

- i. whether the profession is actively involved in insolvency proceedings
- ii. if yes, at which stages
- iii. whether entrepreneurs are seeking the profession's advice
- iv. possible national requirements for certification of a practitioner and
- v. the specific role of the statutory auditor

As mentioned in the introduction, the information is indicative and aims to reach overall conclusions on the profession's contribution in Europe.

Building on its financial and business expertise, the profession can be involved in various stages of insolvency proceedings. In this paper, we are touching upon the profession's roles in two separate but equally important parts. One is its role as an auditor. This part – which is further analysed below – follows defined standards and legislation, which results into an independent audit opinion. The other part consists of a broader role of accountancy profession with respect to various services including early warning, advice, preparing business plans and cash forecasts, or re-organising internal controls and procedures.

### IS THE ACCOUNTANCY PROFESSION ACTIVELY INVOLVED IN INSOLVENCY PROCEEDINGS?

When it comes to legal competence, the accountancy profession's (the profession) formal involvement as insolvency practitioners, seems to be rather limited. In the majority of countries, accountants and auditors are not the primary professionals thought of, when a business is in financial distress or insolvent.

Nevertheless, in several countries the profession is involved in certain stages, especially when the authorities or the client need and seek their advice based on their financial knowledge and background.

In other cases, the country's legislation offers the possibility for the profession to be involved but, in reality, it seems that the profession is de facto not included in this market, therefore not able to contribute.

When it comes to which professions are involved, the majority of respondents added that lawyers seem to be the profession mostly involved in insolvency proceedings. Tax advisors are involved in certain cases while in some countries the court seems to be leading the process by assigning the responsibilities to professionals depending on their expertise. In specific countries, insolvency practitioners constitute a specific, separate profession.

### DOES NATIONAL LAW REQUIRE ANY CERTIFICATION TO BECOME AN INSOLVENCY PRACTITIONER?

According to the feedback received to this question, in most of the cases there is a number of requirements in order to become such a practitioner. Requirements however differ from country to country. In some cases, it is necessary to take exams, while there are requirements for prior experience, training or a combination of all of those. In the received replies, some also specified that there are no requirements at all.

### IN WHICH STAGES IS THE PROFESSION INVOLVED (IF INVOLVED)<sup>5</sup>?

When an accountancy professional is legally involved as an insolvency practitioner, in the majority of cases it relates to re-structuring and less to preventive measures. This can be attributed to a number of reasons, among which that entrepreneurs are not seeking for help at an early stage or the country itself not having established

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<sup>5</sup> This question refers solely to tasks related to the profession taking over the role of insolvency practitioner and it is separate from the specific role of the statutory auditor which is developed below.

proper procedures. In other words, the profession is being used mostly when the financial distress procedure has already started.

Most importantly, the profession seems to have acquired an advisory role in the proceedings<sup>6</sup> based on applied practices. This is because the profession is regularly called upon to assist the procedure and also because entrepreneurs may seek for support when in need of assistance.

## **DO ENTREPRENEURS SEEK FOR ADVICE FROM THE PROFESSION (IN TIME)?**

In the majority of countries, entrepreneurs seek advice from the profession. Nevertheless, in the specific context of insolvency, based on the feedback provided by the respondents, it appears that entrepreneurs may do this at a very late stage in the process.

When the entrepreneur is already a client of the profession, it increases the chances of seeking advice in time.

## **WHAT IS THE SPECIFIC ROLE OF THE STATUTORY AUDITOR?**

A statutory auditor has to obtain sufficient appropriate audit evidence and reach conclusions on the appropriateness of management's use of the "going concern" basis of accounting in the preparation of the financial statements. Also, auditors have to conclude and include in their report whether any material uncertainty exists related to events or conditions possibly casting significant doubt on the entity's ability to continue as a "going concern". This assessment is based on International Standards on Auditing (ISA) 570 on "going concern".

Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a "going concern" as well as standards regarding matters to be considered and disclosures in connection with "going concern". This is the case in the International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB) which are being used to prepare the consolidated financial statements for all EU entities listed on a regulated EU market. The Accounting Directive (2013/34/EU), which forms the basis for accounting and financial reporting frameworks for all other entities in EU Member States, requires a statement on the conformity of the accounting policies with the going concern concept and presumes that the entity carries on its business as a "going concern".

The auditor will also evaluate:

- i. The management's assessment of the entity's ability to continue as a "going concern", (which management has prepared on the basis of forecasts, cash flow predictions etc.)
- ii. That the entity will be a "going concern" for at least 12 months after the balance sheet date.

The auditor has to consider the implications for the auditor's report and include a separate section or express a qualified or adverse audit opinion, if there is material uncertainty related to going concern and/or if these issues have been adequately disclosed in the financial statements (or not).

It is worth clarifying, however, that not all businesses are subject to auditing as they fall below the various set thresholds, across Europe. Statutory audit and voluntary audit make a recognised important contribution to better corporate governance and financial management and can play an instrumental preventive role in reducing insolvency risk.

The assessment of "going concern" is a procedure which can contribute to giving an early warning to management or to flag imminent risks of insolvency depending on the stage of financial distress. Directors themselves also bear primary responsibility in assessing whether the business is insolvent and in taking corresponding initiatives. It is only in a very limited number of countries in Europe that auditors can take further action towards shareholders or the court if management does not react to these warnings. The role of the statutory auditor can contribute to avoid triggering insolvency if management takes the right action subsequent to the auditors' warnings.

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<sup>6</sup> As explained above, this does not regard statutory auditing.

## OFFERING A “HELPING HAND” TO “HONEST” ENTREPRENEURS

Providing a second chance for “honest” entrepreneurs was the key reason the European Commission decided to launch the EU Directive on Business Insolvency. Individuals should not be deterred from entrepreneurial activity or denied the opportunity for a second chance. To encourage entrepreneurship, entrepreneurs and managers of companies should not be stigmatised when “honest” business endeavours fail. An appropriate insolvency framework is important for society at large and in particular for investors, creditors and debtors. In order to see Europe’s economy recovering and growing, there is a need to allow entrepreneurs to take steps forward, without being held back too much by the risks involved. An opportunity for a second chance can relieve entrepreneurs from the fear of failure and pave the way to growth and investments.

The majority of the respondents to the survey consider “culture” as the main reason for entrepreneurs in Europe not benefitting from a second chance. The profession considers that insolvency creates a stigma or a bad reputation in the market for the entrepreneur and this deters them from reviving their business, or sometimes from establishing a new one.

Other reasons are linked to lack of anticipation by entrepreneurs. Often the entrepreneur does not seek help early enough remaining in denial for too long and leaving little scope for the profession or other experts to assist in avoiding insolvency. Consulting an independent professional in time can help an entrepreneur see the viable options for his business, and if still feasible, avoid insolvency. The earlier, the better.

Respondents also referred to the significant lack of efficiency of the proceedings in place in many jurisdictions. In particular, they mentioned that insolvency proceedings take too long because of bureaucracy, or that in some cases liquidation brings the business to its end without any options for debt forgiveness ahead.

### CAN THE PROFESSION ASSIST “HONEST” ENTREPRENEURS WITH EARLY RE-STRUCTURING OR HAVING A SECOND CHANCE?

Replies indicated that the profession can have more than one role in this. The profession can assist the entrepreneur at several stages from preventing financial distress to achieving a new start after the insolvency has been completed. In particular:

The profession can assist in preventing insolvency. As an external and objective observer, accountants can monitor the business’s overall performance and advise their client appropriately. An accountant can ensure that any proposed business plan remains feasible, financial management is the appropriate one and that proper governance is in place. Doing this in a timely manner may become more challenging when the entrepreneur is not already a client. For this reason, it is very important to ensure early access to expert and objective advice when the risk of financial distress is imminent.

It is important for the profession to establish a common approach in order to ensure consistency when providing advice. In specific countries, this is already happening at national level<sup>7</sup>.

The profession can also monitor and plan the restructuring process. Thanks to its financial experience and expertise, the profession can plan a targeted restructuring process on the basis of the needs and the problems of the business<sup>8</sup>.

Looking at a later stage, following the completion of insolvency, the profession can assist the entrepreneur in restarting their business. This can be done mainly by preparing business and financial planning, cash forecasts and reorganising internal control processes.

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<sup>7</sup> Belgian Institute: “Law Concerning the Continuity of the Enterprises”: “[...] If within the period of one month of that notification the debtor does not take the necessary measures to guarantee the continuity of the enterprise for a minimum period of twelve months, the external accountant, the external tax consultant and the auditor may inform in writing the president of the commercial court thereof. In this case article 458 of the Penal Code [professional secret] is not applicable.”

<sup>8</sup> The role of statutory auditor and accountant remains strictly distinct and independent from these references.

Regardless of the stage of the procedure, the profession can also assist the authorities in completing their insolvency tasks. Supporting the business's reporting, through identifying, preparing financial information and providing an objective opinion, addressed to authorities but also to creditors can:

- i. reduce the timing of insolvency proceedings
- ii. increase transparency
- iii. contribute overall to a more efficient insolvency framework

## **HOW TO CONTRIBUTE TO A MORE EFFICIENT INSOLVENCY REGIME IN THE EU – RECOMMENDATIONS FOR THE FUTURE**

There is no doubt that an appropriate insolvency framework is important for society at large and in particular for investors and creditors. It is an essential element of a good business environment and therefore growth and jobs.

The profession supports the European Commission's initiative to set minimum requirements for accomplishing an effective insolvency framework within the EU. As indicated by the input provided by our Member Bodies, the current situation is quite diverse from Member State to Member State.

In addition to this survey, Accountancy Europe has also replied to the Commission's public consultation<sup>9</sup> on "an effective insolvency framework within the EU".

On the basis of the profession's reply<sup>10</sup>, we would like to bring up a number of recommendations when it comes to enhancing insolvency proceedings. These recommendations aim at opening the discussion with the Member States and the European Parliament on how to set up an efficient insolvency regime which can contribute to a more resilient economy in Europe.

### **PRACTITIONERS' BACKGROUND AND EXPERTISE**

The profession supports measures aimed at further specialisation of insolvency practitioners. Having an orderly process is important but finance is at the core of insolvency, therefore having effective financial expertise should be an essential prerequisite for effective insolvency practitioners. This should be further elaborated through experience and training in insolvency.

The involvement of the relevant professional should not necessarily be subject to a court appointment, especially as the accountancy profession offers a high guarantee of competence, objectivity and independence through its Code of Ethics. The ultimate purpose should be to make sure that the entrepreneur receives appropriate guidance from the most appropriate practitioners. Objectivity and consideration for public interest are key when providing advice to prevent and detect insolvency.

We are supportive of establishing EU minimum standards when it comes to the required experience of insolvency practitioners, especially regarding cross border insolvency. Nevertheless, EU Member States should remain flexible on specifics e.g. no need to predefine a minimum period of experience throughout the EU.

### **REDUCING THE LENGTH OF INSOLVENCY PROCEEDINGS**

For its reply to the public consultation, the profession flagged bureaucracy and unnecessarily lengthy procedures as key issues to be addressed in order to establish an efficient insolvency regime. In several cases, it has been noted that the procedures become too formal because of overburdening judicial requirements and processes. In many cases, courts do not have the capacity to deal with the high number of cases. Also, lack of promptness in exercising creditors' rights, delays in the liquidation of the debtor's assets, or the time being

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<sup>9</sup> Launched in March 2016. Available here: [http://ec.europa.eu/justice/newsroom/civil/opinion/160321\\_en.htm](http://ec.europa.eu/justice/newsroom/civil/opinion/160321_en.htm)

<sup>10</sup> You may find the original Accountancy Europe (ex. FEE) reply here: [http://www.fee.be/images/publications/company\\_law/Business\\_insolvency.pdf](http://www.fee.be/images/publications/company_law/Business_insolvency.pdf)

taken to obtain final decisions for the rights and duties of the creditors can contribute to the length of the proceedings.

Overall, the most important goal must be to reduce the cost and length of insolvency proceedings. Communicating the expected cost and time of the proceedings from the very beginning can work as an incentive to reduce the length. EU Member States should decide at national level on a maximum duration for insolvency proceedings or establish a relevant mechanism to be able to terminate insolvency proceedings at a reasonable point. In light of that, it is important to stress again that terminating insolvency brings no added value if an entrepreneur does have an opportunity for a second chance.

Although reducing the length is key to contributing to an efficient insolvency regime, it remains crucial to ensure that appropriate time is devoted in order to ensure all creditors' rights are satisfied. Striking the right balance between this and avoiding unnecessary bureaucracy is key to achieving an efficient insolvency framework.

## **ACCESS TO HELP / ANTICIPATING FINANCIAL DISTRESS**

Entrepreneurs in financial distress should be encouraged to seek help as early as possible. When the business is already a client of a professional accountant, it is easier for the profession to offer its advice and help prevent troubles. Nevertheless, Member States need to raise awareness on availability of expert advice as well as encourage entrepreneurs to seek help at an early stage as well as subsequently.

Debt advice should be available to all, on the condition that it is provided by skilled insolvency practitioners. As previously flagged, it is crucial to make sure that only appropriately qualified insolvency practitioners advise entrepreneurs who seek help.

Cost implications can work as a deterrent especially for small or micro-entities. Member States should also consider incentives or support programmes to make sure that there are viable options for seeking advice available in the market place.

## **MANAGEMENT'S DUTIES**

Directors should be incentivised to take early and appropriate action when there is a warning of financial distress. This however should not work as a means to escape from any liability from earlier actions from directors.

Directors' duties lie in three areas:

- i. general responsibility over the company's course
- ii. early action in case of financial distress and
- iii. keeping proceedings transparent to all parts

As part of management's duties, it is also worth highlighting the role that "accountants in business"<sup>11</sup> can play. An internal accountant should also contribute to preventing or detecting possible insolvency by providing their objective views to management.

## **CROSS-BORDER PROCEEDINGS**

Cross-border implications also need to be looked at when it comes to business insolvency. The European Commission has launched a recast<sup>12</sup> of the 2012 regulation<sup>13</sup> in order to modernise the current rules on cross-border insolvency which dates back to 2000. The main objective of the regulation – with effective date 26 June

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<sup>11</sup> "Professional accountants in business [...] support their organizations in a wide range of job functions, including leadership and management; operational; management accounting and control; and accounting and stakeholder communications." <https://www.ifac.org/about-ifac/professional-accountants-business>

<sup>12</sup> <http://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32015R0848>

<sup>13</sup> <http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:52012PC0744>



2017 – is to avoid the transfer of assets or judicial proceedings from one EU country to another and potentially improve the legal position of companies or individuals.

The profession believes that there is a need to simplify cross-border proceedings and introduce further measures at EU level which would eventually lead to a harmonised environment. International networks of professional accountants and multi-disciplinary practices can also contribute to smoother and more effective cross-border cooperation. Nevertheless, it remains important to make sure national legislation does not create additional bureaucracy and barriers.

## **CONCLUSIONS**

Modernising and simplifying business insolvency can be part of re-boosting economy and growth in the EU. There is a need to look into the financial problems encountered by entrepreneurs and provide them with a helping hand at the stage of early warning or when facilitating insolvency proceedings.

Through its established role in statutory auditing, the profession can provide early warning to management and flag imminent risks of insolvency. Through its independent report, the profession can contribute to avoiding insolvency if the right initiatives are taken by management.

In addition to this role, the accountancy profession can take up broader tasks – thanks to its financial background – providing expertise to entrepreneurs who are facing financial distress, going through insolvency, or looking for a second chance.

It remains important to ensure that entrepreneurs have access to the appropriate expertise and advice at an early stage and that they are also encouraged to seek help. It is also crucial for insolvency practitioners to receive the necessary training and acquire specialised knowledge. The professions involved in insolvency proceedings can cooperate and offer their advice depending on their expertise so the entrepreneur benefits to the maximum.

Cooperation at EU level can simplify cross-border proceedings and can also safeguard more equal levels of opportunity for all entrepreneurs active in Europe.

Following the launch of the Commission's proposal, the European Parliament and Council are expected to kick off discussions in order to reach an operational compromise. The profession remains available for further discussion and exchange of views.



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