Federation of European Accountants
Fédération des Experts comptables Européens

Factsheet

Standing for trust and integrity

November 2014[1]

The June 2013 Accounting Directive

The 2013 Accounting Directive (Directive 2013/34/EU) provides the legal framework for single company and consolidated accounts for undertakings based in the European Union (EU) that must be transposed into the national legislation of each Member State by 20 July 2015 at the latest.

It has already been revised with the addition of a section expanding the disclosure requirements in the management report in respect of non-financial information for certain large companies and groups.

The 2013 Directive[2] is available in the languages of all EU Member States.

Scope and deadlines

When Member States transpose the Directive into their national legislation they must decide how to implement the many Member State options that are available to them. There are over 90 base options available and many of these allow the Member State to “require” or “permit” the option in question, thereby allowing further choice.

FEE has prepared a document[3] summarising the options available to Member States.

Although the European Commission does not anticipate that Member States will experience any problems in meeting the transposition deadline, it is implementing several supporting measures in order to facilitate this transposition, including transposition workshops.

The provisions within the 2013 Directive will first apply to financial statements for financial years commencing on or after the 1st January 2016.

The amendments to the Directive in respect of Non-Financial Reporting were approved by Parliament in April 2014 and were adopted by Council in September 2014.

The undertakings affected by the 2013 Directive include public and private limited liability companies and also unlimited companies and partnerships (limited or otherwise) where all the members have limited liability. Not for profit organisations are excluded. The 2013 Directive provides, for the first time, a full list of all legal forms of undertakings covered by the Directive detailed by each EU Member State.

1 This Factsheet amends and supersedes the Factsheet published in January 2014.

2 The 2013 Directive can be found at :http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32013L0034:EN:NOT

3 This document can be found at: http://www.fee.be/images/Comparison_table_-_47_with_2013_Directive.pdf

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Summary of the main changes

- The 2013 Directive is a re-cast of the 4th and 7th Directives rather than a complete overhaul. Consequently, many of the provisions and, indeed, text in the 2013 Directives has been carried over from the 4th and 7th Directive;
- The 2013 Directive follows a more structured approach to the layout of the Articles, not least arising from the amalgamation of two Directives into one and a small reduction in the number of options available to Member States;
- It starts with the accounting requirements for small undertakings and then adds additional accounting and reporting requirements as undertakings pass the thresholds for medium and large undertakings;
- It contains new size thresholds for small, medium and large undertakings that not only impact on their accounting and reporting requirements but also on the requirement to prepare consolidated financial statements and to have an audit. It also contains the new category of micro-undertaking (technically, this was included in the 4th Directive but only via an amendment thereto made in March 2012);
- It formalises eight fundamental accounting principles (with some Member State options);
- It contains the new requirement for country by country reporting (outside of the financial statements) detailing all payments exceeding € 100 000 per financial year made to governments by large undertakings and public interest entities operating in the forestry and extractive industries;
- There are enhanced disclosure requirements within the management report for non-financial information relating to corporate social responsibility (anticipated to affect only around 6 000 companies across the EU).

Detailed considerations

New size criteria and thresholds

The following are mandatory thresholds for determining the category into which an undertaking (or group of undertakings) falls:

	Turnover		Balance sheet total		Average number of employees	
	Old	**New**	**Old**	**New**	**Old**	**New**
	Million €	Million €	Million €	Million €		
Micro undertakings	n\a	≤ 0.7	n\a	≤ 0.35	n\a	≤ 10
Small undertakings	≤ 8.8	≤ 8	≤ 4.4	≤ 4	≤ 50	≤ 50
Medium-sized undertakings	≤ 35	≤ 40	≤ 17.5	≤ 20	≤ 250	≤ 250
Large Undertakings	> 35	> 40	> 17.5	> 20	> 250	> 250

- The undertaking must be within any two of the three thresholds for two successive accounting periods;
- The default thresholds for small undertakings' turnover and balance sheet total are €8 million and €4 million, respectively. However, Member States have the option to increase either or both of these thresholds for small undertakings up to a maximum €12 million and €6 million, respectively;
- These new thresholds are used for determining which accounting regime the company is subject to, whether it needs to prepare consolidated financial statements and whether it requires an audit;
- Apart from those relating to small undertakings, Member States have no other option to increase or decrease any of the above thresholds.

Fundamental accounting principles

Items presented in the financial statements must be recognised and measured in accordance with the following general principles:

- The undertaking is presumed to be carrying on its business as a **going concern** (this is to be disclosed in the accounting policies);
- Accounting policies and measurement bases shall be applied **consistently between accounting periods**;
- Recognition and measurement shall be on a **prudent basis**, and in particular:
    - Only profits made at the balance sheet date to be recognised;
    - All liabilities arising in the course of a financial year to be recognised even if these only became apparent between the end of the financial year and the date on which the balance sheet is drawn up;
    - All negative value adjustments to be recognised whether the results for the financial year is a profit or a loss;
- Amounts recognised in the balance sheet and profit and loss account shall be computed on the **accruals basis**;
- **Opening balance sheet** for each financial year shall **correspond** to **preceding closing balance sheet**;
- The components of **assets and liabilities shall be valued separately**;
- **Any set-off between assets and liabilities, or between income and expenditure items, shall be prohibited**;
- All items to be accounted for and presented having regard to the **substance of the transaction or arrangement concerned**;
- Items shall be measured in accordance with the principle of **purchase price or production cost**; and
- **Materiality** applies to recognition, measurement, presentation, disclosure and consolidation.

However, there are Member State options in respect to certain of these principles:

- Set-off: may be permitted on the face of the financial statements but the gross amounts must then be disclosed in the notes;
- Substance over form: may completely exempt undertakings from this requirement;
- Materiality: may be restricted to presentation and disclosure only;
- Prudence: may permit or require the recognition of all **foreseeable** liabilities and **potential losses** in respect of a financial year, if these only became apparent between the end of the financial year and the date on which the balance sheet is drawn up.

Measurement at fair value

References to valuation methods designed to take into account the effects of inflation and using the replacement value method (for stock and fixed assets) contained in the 4th Directive have been removed in the 2013 Directive.

However, under the 2013 Directive Member States have the option to:

a) Permit or require undertakings to revalue fixed assets;
b) Permit or require undertakings to value financial instruments at fair value;
c) Permit or require undertakings to measure specified categories of assets other than financial instruments at fair value.

For b) & c) above, Member states have the option to restrict the permission or requirement to consolidated financial statements only or to certain classes of undertakings ("classes" of undertakings not being defined in the Directive).

Composition of the financial statements

Financial Statements must comprise of a balance sheet, profit and loss account and selected notes to the financial statements. Member States have the option to require medium sized and large undertakings to include other statements, such as a cash flow statement or statement of other comprehensive income.

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Balance sheet items

Some of the more important changes and Member State options in respect of balance sheet items are listed below:

- There have been changes to the treatment of goodwill, which is to be amortised over a minimum of 5 years to a maximum of its useful economic life. If the useful economic life cannot be determined then it must be written-off over a period of between 5 and 10 years, selected by the Member State;
- The treatment of other intangible assets now generally follows that of goodwill;
- There is a Member State option to permit or require the related costs of borrowing to be added to the cost of fixed and current assets;
- Subscribed unpaid share capital must be treated as an asset, either shown separately or under the heading of Debtors.

Profit and loss account

Some of the more important changes and Member State options in respect of profit and loss account items are listed below:

- The permitted layouts for the profit and loss account have been reduced from four options to two. The options permitting the presentation of "Charges" before "Income" have been deleted;
- Undertakings are permitted to provide more detail than required on the face of the profit and loss account and Member States have the options to require additional information or for headings to be combined. Member States are also permitted to restrict deviations from the standard formats as far as necessary to facilitate electronic filing;
- There is no heading for extraordinary items in the standard formats (but undertakings can add additional lines and Member States can permit or require additional lines). The 2013 Directive requires disclosure of exceptional items in the notes for medium-sized and large undertakings.

Micro-undertakings

Member States have no option in defining the size criteria for micro-undertakings but have the option whether or not to grant any or all of the following accounting simplifications:

- To **prepare** an abridged balance sheet*;
- To **prepare** an abridged profit & loss account*;
- No obligation to prepare notes to the financial statements nor a management report (providing that details relating to the acquisition of own shares, financial commitments and guarantees and credit arrangements with management and participators is then disclosed at the foot of the balance sheet);
- To use of "Cash +" accounting - the accruals basis is used only for revenue, raw materials\consumables, staff costs, value adjustments to assets and taxation;
- Not to publish annual financial statements as long as the balance sheet information is filed with one national authority.

Micro-undertakings are not permitted to use fair value accounting.

Investment and financial holding undertakings are excluded from these simplifications.

In other respects, micro-undertakings are treated as small undertakings.

Micro-undertakings must still maintain accounting records in accordance with national requirements.

* See example: http://www.fee.be/images/Factsheet_New_Accounting_Directive_1401_Appendix.pdf

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Small undertakings

Member States have the option to apply some, all or none of the following simplifications:

- To prepare an abridged balance sheet*;
- To prepare an abridged profit and loss account (starting with 'Gross profit or loss');
- To prepare notes to the financial statements that only cover:
  - Accounting policies;
  - Revaluations and value adjustments to assets at fair value;
  - Financial commitments;
  - Exceptional items;
  - Amounts owed falling due after more than 5 years;
  - Average number of employees;
  - Credit transactions and commitments relating to members of the managerial body;
- To exempt the preparation of a management report or to permit the preparation of an abridged management report (excluding non-financial key performance indicators);
- To exempt the publication of a profit & loss account and management report.

Medium-sized undertakings

Medium-sized undertakings must fulfil all the requirements relating to small undertakings and then also present and disclose additional information. In respect of the additional information, Member States have the option to apply some, all or none of the following simplifications:

- To prepare an abridged profit & loss account (starting with 'Gross profit or loss');
- To prepare an abridged management report (excluding non-financial key performance indicators);
- To publish an abridged balance sheet; and
- To publish abridged notes to the financial statements. These include all the notes required for small entities plus:
  - Movements in fixed assets;
  - Adjustments to assets arising from tax legislation;
  - Directors' emoluments etc.;
  - Analysis of staffing costs;
  - Details of interests in associates, subsidiaries etc.;
  - Deferred tax provisions and movements;
  - Shares subscribed for (including by class and warrants, if appropriate);
  - Any undertaking of which it is a member with unlimited liability;
  - Ultimate controlling party and location where consolidated accounts are available;
  - Proposed appropriation of profit or loss;
  - Off-balance sheet arrangements;
  - Unadjusted post-balance sheet events;
  - Transactions with related parties (Member State option to restrict these only to transactions not concluded under normal market conditions).

There is a Member State option to require medium-sized undertakings to provide disclosures in the financial statement in addition to those specified in the 2013 Directive.

Large undertakings and public interest entities

Public interest entities (PIEs) are those with traded securities, credit institutions, insurance institutions and any others designated as such by a Member State. This is largely consistent with the definition of PIEs in the new 2014 Statutory Audit Directive, but, as the 2014 Statutory Audit Directive is not bound by the list of entities in the 2013 Accounting Directive, its scope is wider (i.e. partnerships can be defined as a PIE under the Statutory Audit Directive). For more information on the 2014 Statutory Audit Directive and Regulation, please see the FEE Factsheet[4].

There are no simplification options available. In addition to the cumulative reporting requirements for medium-sized undertakings, large undertakings and PIEs are also obliged to publish the following notes to the financial statements:

- Analysis of turnover by geographical markets and type of activity;
- Details of payments made to auditors.

There is a Member State option to require PIEs and large undertakings to provide disclosures in the financial statement in addition to those specified in the 2013 Directive.

Consolidated financial statements

Fundamentally, the requirements in the 2013 Directive are unchanged from those in the 7th Directive.

Small groups must be exempted from preparing consolidated financial statements and Member States may exempt medium-sized groups (unless, in both cases, the group contains a public interest entity).

Management reports

The name has been changed from that of “annual report” in the 4th Directive but the requirements are almost identical. The only significant change is that a description of important events that have occurred since the end of the year has been removed – although this is now subject to a note to the financial statements for medium-sized and large undertakings.

Contents of the management report

The management report shall include:

1. A fair review of the development and performance of the undertaking's business and of its position, together with a description of the principal risks and uncertainties that it faces. The review shall be a balanced and comprehensive analysis and shall include both relevant financial and non- financial key performance indicators.
2. The management report shall also give an indication of:
    a. the undertaking's likely future development;
    b. activities in the field of research and development;
    c. information concerning acquisitions of own shares;
    d. the existence of branches of the undertaking; and
    e. in relation to the undertaking's use of financial instruments and where material:
        i. the undertaking's financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction; and
        ii. the undertaking's exposure to price risk, credit risk, liquidity risk and cash flow risk.

Additionally, the undertaking’s auditor shall express an opinion on whether:

- The management report is consistent with the financial statements;
- The management report is prepared in accordance with the applicable legal requirements;
- Based on the auditor’s knowledge and understanding, there are any material misstatements in the management report.

4 FEE Factsheet and other information on the 2014 Statutory Audit Directive and Regulation can be found at: http://www.fee.be/index.php?option=com_content&view=article&id=1419&Itemid=106&lang=en

Payments to governments (“Country by Country Reporting”)

This is a completely new requirement that affects large undertakings and public interest entities active in the extractive or forestry industries. It requires the disclosure of any payment (or series of payments) to governments totalling € 100 000 or more in a financial year. The payments will include taxation, royalties and, in certain circumstances, dividends.

An annual disclosure is required in a public report that is outside the annual financial statements. Reporting must be made on a country-by-country and project-by-project basis. There is no requirement for the involvement of the undertaking’s auditor.

Disclosure of non-financial and diversity information by certain large companies and groups (“NFI”)

Directive 2014/95/EU [5] amends the 2013 Directive and was adopted by the Parliament and Council in October 2014. There will be a two year transposition period and so the first period of account where these provisions will apply will probably commence on or after 1 January 2017.

These requirements apply only to large undertakings that are PIEs with an average of 500 or more employees. Members States have the option to expand the definition of PIE over that contained in the 2013 Directive.

The new legislation introduces additional non-financial disclosure requirements for large public interest entities in their management report (or in a report separate to the financial statements), providing information on, at least:

- Environmental matters;
- Social and employee-related aspects;
- Respect for human rights, and
- Anti-corruption and bribery issues.

For each of these areas, the undertaking must disclose the following information:

- A description of policies, including due diligence processes implemented;
- Outcomes of these policies;
- The risks relating to those areas and how the company manages those risks.

Also required is a brief description of the undertaking’s business model and also the relevant non-financial key performance indicators.

The Directive adopts a “report or explain” approach - an undertaking that does not pursue policies in one or more of these areas is required to explain why this is the case.

The statutory auditor shall check whether the required information is included in the management report (or separate report). Additionally, Member States may require that the non-financial information be verified by an independent assurance services provider.

An amendment to the corporate governance requirements of the Directive, relating to PIEs, requires the disclosure of the undertaking’s diversity policy in respect of the undertaking’s administrative, management and supervisory bodies.

Further information on this topic can be found in a dedicated FEE Factsheet[6].

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5 The Amended Directive can be found at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN

6 FEE Factsheet and other information can be found at: http://www.fee.be/index.php?option=com_content&view=article&id=1437&Itemid=106&lang=en

Auditing requirements

The financial statements of all public interest entities, medium-sized and large companies must be audited. The 2013 Directive does not require the audit of a small undertaking but permits Member States to require an audit after taking into consideration the specific conditions and needs of small undertakings and users of their financial statements.

Interaction with International Financial Reporting Standards (IFRS)

The 2013 Directive encompasses all companies governed by Member State law whereas the 2002 IAS Regulation only made adoption of IFRSs mandatory for the consolidated financial statements of companies listed in European securities markets. There is a precedence that must be observed for undertakings required to use IFRSs:

- If the IFRSs are silent on a matter then national law (which may be wholly, or partly, based on the Directive) should be referred to for its treatment;
- If there is a conflict between IFRSs and the Directive, the treatment prescribed in the IFRS takes precedence.

Interaction with the International Financial Reporting Standards for Small and Medium Sized Entities (IFRS for SMEs)

The 2013 Directive does not include any specific references to the IFRS for SMEs – the Commission's previously stated position was that IFRS for SMEs would not serve the objectives of simplification and the reduction of administrative burden for SMEs as defined by the EU.

There is no specific prohibition for Member States permitting or demanding that IFRS for SMEs be used by their small or medium sized undertakings, but the 2013 Directive still has two (potential) areas of incompatibility with the IFRS for SMEs. One of the areas of incompatibility is the treatment of amortisation periods for goodwill where the expected useful life cannot be estimated – the IFRS for SMEs demands a 10 year amortisation period and under the 2013 Directive a Member State has the option to choose an amortisation period in such circumstances of between 5 and 10 years. Thus, depending on the Member State's decision, this incompatibility may or may not be an issue.

The other incompatibility relates to the treatment of unpaid subscribed share capital, which the 2013 Directive requires be carried as an asset but which the IFRS for SMEs requires to be offset against equity. Obviously, this is only an issue for undertakings finding themselves in this situation. The IASB has not removed this incompatibility in their latest exposure draft of the standard published in October 2013.

The next step

All 28 EU Member States must transpose the 2013 Directive into national legislation. The Directive contains a considerable number of options that the Member States must consider. FEE member bodies, the accountancy profession and other relevant stakeholders are encouraged to offer assistance to their national governments in advising as to the application of these options in order to achieve the best accounting treatment and the greatest comparability across Member States.

About FEE

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) is an international non-profit organisation based in Brussels that represents 47 institutes of professional accountants and auditors from 36 European countries, including all of the 28 EU member states.

FEE has a combined membership of more than 800.000 professional accountants, working in different capacities in public practice, small and large accountancy firms, businesses of all sizes, government and education – all of whom contribute to a more efficient, transparent and sustainable European economy.