Federation of European Accountants
Fédération des Experts comptables Européens

Mr. Klaus-Heiner Lehne
Chair of the Committee on Legal Affairs
European Parliament
Bât. Altiero Spinelli – 10E205
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Dear Mr. Lehne,

FEE[*] is pleased to provide you its view on the EC proposal for a Directive on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Type of Undertakings ("the Proposal") including comments on amended Transparency Directive[1] ("the Transparency Directive"), which have been issued by the Commission on 26 October 2011.

Building on a thorough debate among our expert groups and different constituencies, we trust the comments below reflect a useful European perspective on these matters, although some of our member organisation may present certain specific comments and proposals rooted in their respective national environments.

In our letter we would like to share firstly some general observations followed by a few suggestions for changes to specific provisions of the Proposal and the Transparency Directive that you may wish to consider.

FEE supports the objectives of better regulation and simplification

(1) FEE welcomes proposals aimed at better regulation and simplification, as well as reducing excessive and unnecessary administrative burdens. Measures seeking to directly help job creation in the Member States have an important role to play in helping companies in general and in particular small and medium sized companies, increasing productivity and promoting entrepreneurship. It is conceivable that entrepreneurship, through its innovation, greatly contributes to economic recovery and sustainable growth.

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[1] EC Directive proposal on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC

(2) We also support the objective of improving European-wide comparability of the financial statements, especially for medium sized and large non-listed companies. This is particularly important in order to create a single market and support increased cross border operations as well as mergers and acquisitions of many European businesses.

(3) We also welcome the Commission's efforts to allow simplification in the reporting obligations of "small issuers", to increase financial integration of European securities markets and to redirect the focus on longer term results.

(4) We commend the Proposal for replacing the existing two Accounting Directives by a single one. They have been in place for many years and amended only on a piecemeal basis, resulting in requirements that are not addressing all the currently relevant accounting subjects. The introduction of the materiality principle and the mandatory use of the substance over form principle are particularly welcomed in this respect in order to avoid information overload, support simplification as well as reflect the economic reality and not merely the legal form of the transaction.

The Accounting Directives need a complete overhaul

(5) The Commission should, in our view, have considered and carried out a broader exercise focused on a more fundamental review to better adapt the Directives to 21st century accounting requirements characterised by principles-based standards and reflecting the dynamic developments in corporate reporting. A more holistic approach, which we strongly favoured, would have required a complete revision of the existing Accounting Directives.

(6) Therefore, we see the current Proposal as a positive step, although only first step towards such a goal. In our view, the future reporting requirements should introduce high-level principles based on an overarching accounting framework which sets the boundaries upon which detailed requirements can be outlined. This principles-based accounting framework should provide a sound conceptual basis for financial reporting describing the objective and the users of the financial statements as well as other qualitative characteristics of useful financial information such as relevance, timeliness, verifiability and understandability. In addition, common examples should be provided as guidelines which can be practically used in a variety of circumstances. Introducing unnecessary detailed requirements for all specific circumstances reduces flexibility and adaptability to the evolving needs of businesses and report users while the accounting theory and international financial reporting standards continue to evolve.

Accounting and auditing should not be characterised as burdens

(7) We find it inappropriate that the Proposal characterises accounting including the preparation of the financial statements and auditing as "burdens" without recognising its beneficial role and added-value to corporate management and the economy as well as its public interest dimension. While there have been attempts to measure the costs, no real efforts were made to assess the benefits.

(8) In practice, accounting is an essential management tool: it facilitates access to finance and creates the trust that enables trade. Auditing provides independent and objective assurance designed to add to the credibility and reliability of the financial information and contributes to enhancing the operational effectiveness of the internal control system related to financial reporting.

(9) In order to achieve real benefits for companies and society, the simplification objectives need to be balanced with other public policy goals such as stakeholders' information, investors' protection, markets' stability, the reduction of transaction costs and the cost of capital; this is particularly important for SMEs’ access to finance. An approach which characterises accounting and auditing as "burdens" without considering their added-value will in reality fail to achieve its envisioned benefits.

(10) There is also a risk that a disproportionate reduction of the accounting and auditing requirements for small companies could lead to a significant reduction in the quality and usefulness of the financial information available to users such as trade creditors, business partners, managers, investors, employees, etc. Reliable and relevant financial information to users is a significant contributor to the efficient functioning of the economy and internal market. It also supports integration of new economies into the EU and dissemination of best practices.

Permit the use of IFRS for SMEs

(11) From a European perspective, FEE regrets that the Proposal does not seize the opportunity to allow Member States to make their own decision regarding IFRS for SMEs[2]. It is unfortunate that this opportunity is missed because of differences in the accounting treatment of relatively minor matters between the Proposal and the current IFRS for SMEs[3].

(12) FEE supports high quality and principles-based global standards in financial reporting, which promote consistency and transparency: we believe that IFRS for SMEs fulfils these characteristics particularly for larger SMEs and large unlisted entities.

(13) There are a number of potential benefits to adopting IFRS for SMEs, including enhancing the comparability of financial statements, providing more relevant information to financial statement’s users while balancing the costs and benefits from a preparer perspective and improving access to international funding. In conducting business with limited liability companies in different countries, lenders, creditors and other investors would benefit from a comprehensive financial reporting standard, which would improve the efficiency of cross border activities. Furthermore this would allow Member States which currently, in line with the relevant IFRS regulation, require the use of full IFRS for all limited liability companies, to ease the requirements for other than large companies without the necessity to develop their own national accounting framework.

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2 However France and Italy do not support this.

3 Differences are in the areas of presentation of unpaid subscribed share capital and the amortisation periods for goodwill whose expected useful life cannot be reliably estimated.

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FEE questions the real benefits of a fully harmonised reporting regime for small companies

(14) We support the proposed principle which requires the company, regardless of its size, to ensure that the financial information included in the financial statements gives a true and fair view of its financial condition and operating result.

(15) Article 4, General Provision, together with Article 17, Content to Notes to the Financial Statements, create a fully harmonised regime for the preparation of small companies' financial statements. Small companies will, overall, have a more limited disclosure regime, when compared to the previous Directives. Member States are not allowed to require the presentation of further information although such information is very likely to be needed to fulfil the general principle of true and fair view.

(16) Therefore, there is a concern that the prohibition of additional mandatory disclosures for small companies is likely to lead to a decline in the quality of the financial information available to users, while it will not result in any significant cost reductions because detailed accounting records containing such additional information must be kept by the company. Instead, it will mean that relevant information is not disclosed and stakeholders will lose confidence in whether all relevant disclosures have been made. Stakeholders, e.g. creditors and bankers, will continue to require a certain level of information, but in varying forms, thus creating additional reporting burdens for small companies. Relevant and reliable information not only enhances transparency, but is in many, if not all cases, needed for tax compliance.

(17) It is also difficult for us to follow the logic of EU legislation which requires full harmonisation of listed (through the mandatory adoption of IFRS) and small companies, whereas it proposes minimum harmonisation for medium-sized and large unlisted companies.

(18) For these reasons, we recommend deleting Article 17.2 and giving the Member States the option to add those further disclosure requirements for small companies that they deem needed under their particular circumstances, since we believe this reflects fully the subsidiarity principle of the EU Treaties.

Clarify the audit requirement for small companies

(19) The proposal lays down the general audit requirement for the annual financial statements of medium and large companies. However, it remains silent regarding the audit of small companies.

(20) FEE believes that Member States should continue to be able to decide whether they want to exempt small companies from audit requirements, as they are best placed to determine the actual need of small entities to be exempted from audit based on the principle of proportionality, the relative size of companies and the characteristics of the economy. The consequences of an exemption on tax assessment and inspection systems of individual Member States can also be a major matter of concern.

Permit Merger accounting as a simplification measure

(21) The provisions allowing merger accounting have been removed from the Proposal. This is likely to be of concern to many companies as merger accounting is widely used, particularly when accounting for transactions under common control or for group restructuring, where such treatment is also allowed by IFRS. It would also be burdensome to require acquisition accounting which requires detailed fair value assessment of assets and liabilities in these circumstances.

(22) Therefore, we recommend reinstalling the option for Member States to permit, but not require, merger accounting for transactions under common control or for group restructuring.

Consider the benefits of Cash flow statements

(23) We are of the view that the current drafting represents a missed opportunity to prescribe the preparation and presentation of a cash flow statement for certain types of companies in the Proposal. The cash flow statement is regarded as an essential tool to provide relevant information about the cash generating capacity of a company and to assist in making the connection between the balance sheet and profit and loss account. It gives, in combination with the profit and loss account, a more rounded and complete view of the performance and cash generation capacity of a company, which is particularly important in periods of instability.

(24) Therefore, we believe that the inclusion of the cash flow statement in the annual financial statements should become mandatory for large companies and should remain as an option for Member State to require it for medium-sized companies. For small companies the benefits of providing such a statement may not outweigh the costs of preparation, therefore we support the EC proposal not to require such statement for small companies.

Country-by-Country reporting should be in a separate report

(25) Both the Proposal and the Transparency Directive introduce a requirement for companies in the extractive industries and certain forestry companies to provide disclosures about their payments to government on a country-by-country basis.

(26) FEE is supportive of the efforts by the Commission to improve transparency and accountability in resource rich emerging economies, although we do not believe that these objectives can best be met through disclosure in the annual report, since this document is produced particularly to meet the information needs of investors.

(27) Therefore, we recommend that the Proposal and Transparency Directive explicitly provide for presentation of this information in a separate document outside of the annual report, probably available on company's websites. In addition, having divergent requirements in these two directives would be inefficient and burdensome. Therefore consistency between the two directives should be ensured.

Regulate distributions from company's reserves in the Company Law Directive

(28) Article 6.2 imposes restrictions on distributions from the revaluation reserve. However, the Second Company Law Directive is, in our view, the best place to deal with restrictions over distributions. The Accounting Directive regulates financial reporting, not distributions, and the inclusion of the restriction on the distribution of the revaluation reserve in Article 6.2 is therefore an anomaly and does not cover all similar cases.

(29) Therefore, we suggest deleting the third sentence in Article 6.2.

Avoid prescribing standard forms for management reports in the Transparency Directive

(30) We understand that the EC's intention to propose standard forms for management reports developed by ESMA was to simplify the reporting requirements for small issuers in the Transparency Directive. However, we are concerned that a *one size fits all* approach will fail in this case as management reports cover different aspects of a company's business. Moreover, companies of various sizes from a whole range of industries face different risks and issues that need to be disclosed in such reports. FEE therefore recommends avoiding standardised forms and templates as legislated in Article 4 point 7.

Overall, we believe that the Proposal and the Transparency Directive should be supported and improved. We hope our comments, based on the experience and expertise of European accountants, may be of help to Members of the European Parliament when considering this important matter. Should you wish to discuss any of these points in more details, please contact our CEO, Olivier Boutellis-Taft (obt@fee.be).

Sincerely,

Philip Johnson
President

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[*] **About FEE**

FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) is an international non-profit organisation based in Brussels that represents 45 institutes of professional accountants and auditors from 33 European countries, including all of the 27 EU Member States.

FEE has a combined membership of more than 700.000 professional accountants, working in different capacities in public practice, small and big accountancy firms, businesses of all sizes, government and education, who all contribute to a more efficient, transparent and sustainable European economy.