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To:	Working Party on Company Law
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Subject:	Proposal for a Directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings

In view of the meeting of the Working Party on Company Law on 16 February 2012, delegations will find attached a note by the Presidency.

PRESIDENCY DISCUSSION PAPER ON THE REGIME FOR SMALL UNDERTAKINGS – REDUCING THE BURDENS

With this paper the Danish Presidency wishes to provide a basis for further discussions in the working party. A number of possible solutions are presented in order to cater for the concerns raised by the Member States in regards to the reduced requirements for small undertakings and the use of maximum harmonisation. At the Council working party on 16th of February 2012 the Presidency will invite the delegations to answer the questions set out in this document. The views brought forward by the delegations will be used in the process aiming at a Council agreement by consensus for a compromise text.

The Commission has issued a proposal for a new accounting directive to replace the existing 4th and 7th company law directives.

One of the major changes is the proposed "small-regime". The aim of the small-regime is to ease administrative burdens and to create a more harmonized regime for financial statements for small undertakings.

According to the impact assessment the small-regime will reduce administrative burdens by an aggregated amount of EUR 1 bn. by harmonising the requirements for notes to the financial statement.

The reduction is achieved by reducing the requirements for disclosures, including the elimination of national requirements that go beyond the directives.

The argument is made that the reduction of burdens reduces the costs for the undertakings and will make them more competitive. This will again foster a business climate that encourages company formation and entrepreneurship and therefore potentially foster growth - something that is much needed at the moment.

Several Member States have raised concerns related to the proposed small-regime in their answers to the written consultation that ended on 20 January 2012 as well as at the council working parties.

The concerns have in particular been related to the large number of undertakings covered by the maximum harmonisation and the reduced flexibility for the individual Member States.

However other Member States have expressed support for the proposed small-regime by stating that it will help foster growth and reduce administrative burdens as well as help comparability of the annual accounts in the internal market and therefore be the first step towards a thorough single market for annual accounts.

The Presidency proposes two ways forward bearing in mind that the aim of the proposal is to reduce administrative burdens and increase clarity and comparability of financial statements for small undertakings:

a) maximum harmonisation as proposed, with no additional reporting requirements, or

b) maximum harmonisation with some flexibility

Q1. Which way forward is the preferred option: maximum harmonisation or harmonisation with some flexibility?

If maximum harmonisation with flexibility is the preferred option, different ways to incorporate such flexibility in the compromise text could be explored.

An overarching item in the proposal is that the same size criteria defining small, medium-sized and large companies should apply in all the Member States. Around 96% of limited companies in the EU would be defined as small companies – this percentage would however be higher or lower from one Member State to another.

Increased flexibility for Member States could be achieved by allowing the Member States to adjust thresholds by say, 10 % below or above the proposed thresholds when implementing the size criteria for small undertakings.

Q2. Should there be flexibility regarding the thresholds? Would predefined limits for the thresholds, giving the Member States the opportunity to adapt the size criteria to their local environment, be an acceptable way forward?

The limitation on notes to be prepared by small undertakings, which the proposal is aiming to achieve in order to reduce the administrative burdens also represents an area where more flexibility could be explored. Further notes could be required or left to the discretion of Member States, however this would possibly result in a loss of comparability and reduced simplification. Some of the notes required in the proposal are on the other hand not presently required from all small undertakings. A possibility might be to keep Article 17 but allow the individual Member States to require the disclosure of up to 3 specified (at an EU level) additional items coming from Article 18.

Q3. Should there be a possibility to require up to three specific extra notes for small undertakings, such notes being taken from those for medium-sized undertakings as detailed in Article 18? If there were the possibility to require up to three additional notes, which notes should they be and for what reasons?

Q4. Are there mandatory notes in the proposal where there should be some flexibility around requiring them?

Finally, it is proposed to give small undertakings the ability to prepare and file abridged accounts. This may have an impact for instance where a Member State uses the same information for accounting and tax or statistical purposes. Such an option could be linked to a Member State requirement for "one-stop-shop" filing of accounts, tax returns and statistical data.

Q5. Should it be a Member State option to permit undertakings to present abridged profit & loss accounts and balance sheets? Should such an option be linked to a requirement for a "one-stop-shop" filing process?

Background information is given in the following pages in support of the suggested ways forward above.

Background information

The Commission proposal contains a specific regime for small undertakings ("small-regime"). The major changes for small undertakings in the proposal compared to the existing accounting directives are, as already mentioned, the maximum harmonisation.

Due to the exemption in the proposals article 46 the Member States shall not make the simplifications and exemptions available for public interest entities. Credit institutions and insurance undertakings will therefore not be within the scope of the small-regime.

Maximum harmonisation measures are to be found in the proposal in following provisions:

- Article 3: Pre-defined size-criteria – all undertakings (harmonisation of the thresholds)
- Article 4(1): Small undertakings - no statements in the annual financial statements other than the balance sheet, the profit & loss and the notes.
- Article 4(5): Small undertakings - no information in annual financial statements which is additional to that required in the Directive
- Article 16(1): Small undertakings - Member States shall permit small undertakings to draw up abridged balance sheets
- Article 16(2): Small and Medium-sized undertakings – Member States shall permit small and medium-sized undertakings to draw up abridged profit and loss accounts
- Article 17(2): Small undertakings - Member States shall not require further disclosure for small undertakings beyond what is required by this Article

– Article 24(1): Small groups - Member States shall not require them to draw up consolidated financial statements and a consolidated management report.

Maximum harmonisation in the proposal is therefore circumscribed to specific areas. This should be seen as a need to harmonise all the items listed above, but not more than this.

In seeking to reduce administrative burdens the proposal is closely related to the amendment to Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities. The micro regime is not yet transposed into the proposal, but will be transposed into the compromise text.

Member States can exempt micro entities from a number of accounting requirements[1]. It will not be possible for Member States – according to the current proposal – to require disclosures beyond what is required for small undertakings. Therefore the micro-entities cannot be subject to more requirements than the small undertakings.

Medium-sized and large undertakings will be subject to minimum harmonisation on lay-out. Consolidated accounts for companies listed on regulated markets will be subject to maximum harmonisation by mandatory use of IFRS.

Contrary to the existing Directives the thresholds for small, medium-sized and large undertakings will be mandatory without the possibility for the individual Member States to implement lower thresholds. According to the impact assessment 19 Member States are currently using thresholds below the maximum allowed thresholds in the existing Directive when defining small undertakings.

In some Member States part of the legislation only contains the basic principles, while the more detailed regulation is left to a standardsetter who defines national GAAP. In some Member States the maximum harmonisation could require changes to national GAAP.

[1] The micro-regime covers undertakings not exceeding two out of three criteria being a balance sheet total of 350,000 EUR, a net turnover of 700,000 EUR and an average number of 10 employees during the financial year.

In areas not covered by the maximum harmonisation, Member States may add national requirements. For instance, even though the proposal does not require an audit of small companies, Member States may decide otherwise under their responsibility.

There are also no maximum harmonisation on recognition and measurement but in these areas there are Member State options which provide flexibility for the individual Member States.

1. The proposed small-regime

The current Commission proposal contains maximum harmonisation on thresholds, presentation and disclosures.

Some Member States have expressed their support for the principle of maximum harmonisation due to the reduction of administrative burdens and a more harmonised legislation throughout the EU.

However, a number of Member States have stated that they find the maximum harmonisation of notes to the financial statement too far-reaching and have expressed concerns as to whether the users of financial statements will receive adequate information. To satisfy the needs for users of financial statements in these Member States additional disclosures would have to be added to the notes included in the maximum harmonisation. However it should be very clear that every time a new requirement is added it will increase the administrative burdens.

Some Member States have argued that a restriction for the Member States to require additional disclosures in the financial statement could very likely result in various national authorities and stakeholders in general asking for financial information other than what is disclosed in the financial statements. Such different requests from different stakeholders would most probably cause additional burdens. Requirements to provide additional disclosure could e.g. stem from tax authorities and statistical authorities.

The result may be that some disclosures will be removed from the financial statements, but introduced in new documents. This may increase the burdens of undertakings, as they in the future must prepare and file two documents - to two different authorities – instead of one document to one authority. This might undermine the principle of the "one-stop shop" for filing to authorities.

It has also been mentioned that maximum harmonisation will hinder the Member States from reacting timely to changes in the economic environment. Any change must be suggested by the Commission, be negotiated among the Member States and the European Parliament, before then being transposed into national law. This is a very long process from unveiling a problem to implementing a solution.

In attempting to identify a level of disclosure requirements for small undertakings which would prove to be an acceptable compromise for the Member States we might very well end up having added a large number of requirements to notes to financial statements. In doing so we would jeopardise the main intention of revising the directive and at the same time increase the administrative burdens.

As all disclosure requirements must be in the directives (and not only in the national law in the Member States that decide on add-ons) there is a risk, that the requirements in the directive may in fact cause an increase of burdens in those Member States that already use all exemptions in the directives and have no national add-ons, but there would still be an overall decrease of administrative costs at EU level.

In addition, the proposed regime for small undertakings might in itself result in increased burdens for small undertakings in some Member States (at least one has reported so) even if no further requirements are added.

2. A more flexible regime

There are several ways of introducing a more flexible regime. The flexibility could for instance be achieved by making flexible thresholds, relaxing the maximum harmonisation on notes or removal of the requirement to permit small undertakings to draw up abridged accounts – or any combination of these.

However, an increase in flexibility for the individual Member States will cause less harmonized requirements throughout the EU. Moreover, it is very important that any adjustments to the directives reduce the burdens of the undertakings.

Below, the Presidency has described some possible amendments to the proposal, to try to create a compromise between the different approaches, taken into account the concerns raised by Member States. This will be the basis for further discussions on the topic of maximum harmonisation.

2a. Flexible thresholds

One of the major concerns is related to the number of undertakings within the scope of the mini-regime. According to the impact assessment prepared by the Commission approx. 96 % of the undertakings within the scope of the directive are to be classified as small undertakings and in some Member States the percentage will be even higher. Some Member States have indicated, that they will have only very few undertakings that will be classified as medium sized or large.

On the other hand several Member States have expressed that they are in favour of defining even higher thresholds for small undertakings. Higher thresholds would lead to a reduction of required notes in the financial statements for undertakings who reclassifies from medium-sized to small. Hereby the administrative burdens will decrease. Furthermore the number of undertakings for which statutory audit is required will decrease.

The structure of companies (large versus small) may differ between the Member States and so will the perception of what a large undertaking is. The differences in the economic environments in the Member States can cause that an undertaking in one Member State is to be considered insignificant while it would have been considered significant if it had been located in another Member State.

The economic environment is determined by various factors as for example the aggregated size of the economy of the Member State, the wage level and purchase power. If one for instance looks at the "Big Mac Index" the price of a burger differs from 2,58 $ to 5,91 $ within the Union. Thus an undertaking must sell twice the number of hamburgers in one Member State compared to another Member State before the undertaking is to be classified as a medium-sized undertaking.

These basic differences in the economies in the Member States could indicate a need for flexible thresholds. Increased flexibility for Member States could be achieved by allowing the Member States to adjust thresholds, say by 10 % below or above the thresholds in article 3 in the proposal when implementing the size criteria for small undertakings.

Semi flexible thresholds will lead to a more flexible regime and will make it possible for the individual Member States to adjust the thresholds to the economic environment in that country.

However, the Member States will only have the option to reclassify a number of undertakings to the category medium-sized (or large). These undertakings will be covered by all the minimum requirements for medium-sized undertakings which will add a significant amount of administrative burdens for these undertakings.

Due to current differences in thresholds through-out the EU the flexible thresholds would lead to a lower degree of harmonisation compared to the proposed small-regime.

Finally, flexible thresholds will not solve the concerns related to the missing flexibility for small undertakings. Undertakings classified as small will still be subject to maximum harmonisation without the possibility for the national authorities to require additional notes etc.

2b. Increased flexibility for notes to the financial statements

Some Member States have made use of a great number of options in the existing directives to limit the requirements for notes to the financial statements for small undertakings and hereby to reduce the burden for these undertakings. In such Member States the Commission proposal on maximum harmonisation on notes to the financial statement for small undertakings may result in an increase of administrative burdens

On the other hand several Member States have stated that they find the reduction of the number of required notes too far-reaching and have expressed concerns on whether users of financial statements will find sufficient information in the financial statements.

Introducing Member State options in the comprise text allowing Member States to require specific additional notes to the financial statement will increase the flexibility for the Member States and thereby probably remove some Member State concerns. Another benefit from allowing Member States to require additional disclosure could be that the Member States could create a "one-stop shop" i.e. creating a national regime which could also satisfy needs for tax- and statistical authorities.

By incorporating flexible notes it might be possible to reduce the number of notes which is to be required by all Member States. For instance the individual Member State could consider whether the note on related parties should be mandatory for small undertakings.

By changing some notes from being mandatory to be permitted by the Member States and by adding further optional notes flexibility will be increased. By implementing the requirement for notes to the financial statements at a national level the Member States will be able to customize the requirements to the economic environment in their Member State.

However, the increase in flexibility would lead to a lower degree of harmonisation through-out the EU and as a consequence a decrease in comparability.

Because the Member States by introducing flexible notes only will be permitted to require specific notes in the financial statements the Member States will still not necessarily have the ability to act quickly to changes in their economic environment.

Furthermore the introduction of flexible notes could result in an extensive number of permitted notes. This could potentially result in "gold-plating" by the Member States with no or limited burden reduction as a consequence.

2c. Removal of the requirement to permit abridged accounts

Some Member States have stated that the requirement for permitting abridged balance sheet should be a Member State option.

It is stated that removal of the subclassification in the profit and loss accounts and balance sheet would cause a significant loss of information for the users of financial statements and that the removal could cause the statistical authorities to require the information in another document.

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