



COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Council Directives 78/660/EEC, 83/349/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies and insurance undertakings

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. INTRODUCTION

The 23-24 March 2000 Lisbon Council Conclusions stressed the need to accelerate completion of the internal market for financial services, set a deadline of 2005 to implement the Commission's Financial Services Action Plan and urged that steps be taken to enhance the comparability of financial statements prepared by EU companies whose securities are listed on a regulated market.

On 13 June 2000, the Commission adopted its Communication *The EU's Financial Reporting Strategy: The Way Forward*¹. The Communication proposes that all EU listed companies should be required to prepare their consolidated accounts in accordance with a single set of accounting standards, namely International Accounting Standards (IAS), from 2005 at the latest. Adoption of uniform, high quality financial reporting rules in EU capital markets will enhance overall market efficiency, thereby reducing the cost of capital for companies.

On 17 July 2000, the ECOFIN Council welcomed the June 2000 Communication and emphasised in its conclusions that the comparability of the financial statements of EU listed undertakings, financial institutions and insurance undertakings is an essential aspect of the integration of the financial markets. ECOFIN also invited the Commission to present a proposal to introduce the new requirement and to establish an appropriate mechanism for recognising IAS.

On 13 February 2001, the Commission adopted a proposal for a Regulation of the European Parliament and of the Council on the application of international accounting standards² ('the IAS Regulation'). The proposal sets out the mechanism for recognising IAS in the EU – that they are considered vis-à-vis specified criteria and if considered suitable on the basis of those criteria they be 'adopted' by the EU.

Most significantly, the proposal for a Regulation introduces the requirement that, from 2005 onwards, all EU listed companies prepare their consolidated financial statements in accordance with these adopted IAS. It also provides an option for Member States to permit or require the application of adopted IAS in the preparation of annual accounts and to permit or require the application of adopted IAS by unlisted companies.

A recent survey³ of 700 EU listed companies reveals that 79% of Chief Financial Officers support the European Commission's recommendation that IAS should be mandatory for EU listed companies by 2005. Strategic business and financial considerations, ahead of accounting issues, are the most compelling reasons for considering the change to IAS. These include marketability, cross-border mergers and acquisitions, shareholder dialogue and finance raising.

Current EU accounting requirements are based primarily upon the following EU legislation (hereafter collectively referred to as the 'Accounting Directives'):

¹ COM (2000)359, 13.06.2000

² COM (2001)80, 13.02.2001

³ PricewaterhouseCoopers – International Accounting Standards in Europe – 2005 or now?

- The Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies sets out the requirements in respect of the preparation of the annual accounts of companies⁴.
- The Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts sets out the requirements in respect of the preparation of consolidated accounts⁵.
- Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions deals with those matters specific to such institutions⁶; and
- Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings sets out the specific requirements relevant to the preparation of accounts of such entities⁷.

The Accounting Directives will play an important role in the mechanism for adopting IAS under the proposed IAS Regulation. In addition, they will continue to be the basis of accounting legislation for entities which do not prepare their annual or consolidated accounts in accordance with adopted IAS further to the IAS Regulation. Finally, they deal with important matters which are outside the scope of the IAS Regulation (for example the requirement to obtain an audit and to prepare an annual report) and will continue to govern these areas.

The Accounting Directives have remained largely unchanged since their adoption as much as 23 years ago. In this time, accounting theory and accepted practice have developed significantly and continue to do so. Numerous studies have been prepared or received by the Commission which indicate that, in many respects, the Accounting Directives remain consistent with current accounting theory and practice. However, in certain limited areas, their requirements are incompatible with IAS which the EU will seek to adopt further to the IAS Regulation. This situation is unacceptable for two reasons:

Firstly, if the Accounting Directives are to play an important role in the mechanism for adopting IAS under the proposed IAS Regulation, they must reflect current accounting developments. In this respect, the Directives should be structured so as to accommodate and to be consistent with future incremental developments within IAS – it should not be necessary to consider amendment of the Directives each time a new IAS is proposed.

Secondly, there must be a level playing field between companies which apply IAS and those which do not. Such a position is necessary to enable also a smooth transition when companies seek a public listing.

The objectives of this proposal are therefore threefold:

- (1) To remove all existing conflicts between the Accounting Directives and IAS;

⁴ OJ No L222, 14. 8. 1978, p. 11, Directive as last amended by Directive 2001/65/EEC (OJ No L283, 27. 10. 2001, p. 28)

⁵ OJ No L193, 18. 7. 1983, p. 1, Directive as last amended by Directive 2001/65/EEC (OJ No L283, 27. 10. 2001, p. 28)

⁶ OJ No L372, 31. 12. 1986, p. 1, Directive as last amended by Directive 2001/65/EEC (OJ No L283, 27. 10. 2001, p. 28)

⁷ OJ No L374, 31. 12. 1991, p. 7

- (2) To ensure that optional accounting treatments currently available under IAS are available to EU companies which continue to have the Accounting Directives as the basis of their accounting legislation (ie those companies which do not prepare their annual or consolidated accounts in accordance with adopted IAS further to the IAS Regulation); and
- (3) To update the fundamental structure of the Accounting Directives so that they provide a framework for financial reporting that is both consistent with modern practice and flexible enough to allow for future developments in IAS.

The proposed changes will remove all inconsistencies between Directives 78/660/EEC, 83/349/EEC and 91/674/EEC and IAS in existence at 1 May 2002.

The Commission will present in due course consistent proposals in respect of Directive 86/635/EEC of 8 December 1986 concerning the annual accounts and consolidated accounts of banks and other financial institutions.

2. TIMING AND DATE OF APPLICATION

It is noted above that Lisbon Council set a deadline of 2005 for the implementation of the Commission's Financial Services Action Plan. The IAS Regulation and the modernisation of the Accounting Directives are each essential components of the Plan. In order to successfully meet this deadline, both components must be in place before 2005. Accordingly, it is extremely important to implement the proposed legislation as soon as possible.

3. OUTLINE OF THE CONTENTS OF THIS PROPOSAL

3.1. Article 1

Further to the objectives set out above, Article 1 makes those changes necessary to the Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies.

Paragraph 1 – It is common practice for certain additional statements to be provided in annual accounts, for example a cash flow statement. This revision expressly empowers Member States to permit or require such statements be included in annual accounts. See also similar amendment in respect of consolidated accounts in Article 2, paragraph 7.

Paragraph 2 – The accounting principle of 'substance over form' – where the economic effect of a transaction or arrangement is considered in addition to its legal form – is already embodied in the Accounting Directives (for example, in determining the identity of subsidiary undertakings). This is consistent with the requirement that the annual (and consolidated) accounts shall give a 'true and fair view' (Article 2(3)).

In addition to the recognition of these items is the manner of their disclosure within the prescriptive formats for the profit and loss account and balance sheet specified in the Directive. Under IAS certain transactions and arrangements must be disclosed in the profit and loss account and balance sheet within items which reflect the substance of the transaction or arrangement rather than its legal form. This revision expressly empowers Member States to permit or require that, in determining within which format item an amount should be included, regard may be had to substance as well as form.

Paragraphs 3 and 6 – The balance sheet formats set out in Articles 9 and 10 of the 4th Directive would not, in all circumstances, permit a balance sheet to be reported in accordance with the requirements of IAS. It is considered that the balance sheet disclosure requirements of IAS will provide comparable information and that, accordingly, it is appropriate to empower Member States to allow disclosure in this manner, as an alternative to the formats prescribed in Articles 9 and 10.

Paragraphs 4, 5, 7, 9 and 11 – IAS 37 *Provisions, contingent liabilities and contingent assets* sets out specific requirements as to which amounts should be recorded as provisions for liabilities. In the 4th Directive, Article 31 sets out certain basic rules as to the liabilities which must be taken into account in preparing the annual accounts and Article 20 expands on these principles, giving specific rules for provisions.

The provisions recorded under IAS are more specific than those under the 4th Directive. In particular, IAS restricts the amounts recorded to those obligations which exist at the balance sheet date. In addition to such amounts, the 4th Directive envisages also the provision of liabilities which are ‘foreseeable’. The proposal resolves this inconsistency in the case of companies applying IAS without necessarily changing the status quo for annual accounts and unlisted companies. This has been achieved by amending Article 31 to require the recognition of amounts consistent with IAS whilst allowing Member States to continue to permit or require those additional amounts currently envisaged by the Directive. In addition, certain minor changes to terminology and references have been proposed to facilitate the application of IAS 37.

Paragraph 8 – This revision relates to the presentation of the profit and loss account of the company, a statement which records income and expenditure of the company and whose purpose is to reflect its financial performance. Other gains and losses, for example those which arise on certain assets and which are considered to be unrealised, are currently reported directly in the reserves of the company, if they are recorded at all.

The profit and loss account formats set out in Articles 22 to 26 of the 4th Directive are compatible with the current requirements of IAS. However, the presentation of performance is current being reconsidered by accounting standard setters worldwide, including the International Accounting Standards Board. It is considered highly probable that at some point in the future the income and expenditure currently shown in the profit and loss account will be presented together with other gains and losses in a comprehensive statement of total performance for the period. Accordingly, the proposals provide in the Directive some flexibility such that its requirements will be compatible with these anticipated developments.

Paragraph 10 – IAS 38 *Intangible assets* permits the revaluation, in certain prescribed circumstances, of intangible fixed assets. The 4th Directive explicitly permits the revaluation of **tangible** fixed assets; it does not refer to the revaluation of intangible assets. The proposed revision amends Article 33(1)(c) so as to allow Member States to permit the revaluation of any fixed asset, including intangibles.

Paragraph 12 and 22 – In May 2001 a Directive (2001/65/EEC⁸) was adopted amending the 4th Directive so as to permit financial instruments to be recorded at their fair value and for the gains and losses which arise to be recorded in the profit and loss account. This was necessary

⁸ OJ No L283, 27. 10. 2001, p. 28

in order to permit the application of IAS 39 *Financial instruments: Recognition and measurement*.

Other IASs require or permit the recognition of certain classes of asset at their fair value; notably IAS 40 *Investment property* and IAS 41 *Agriculture*. These standards contain detailed requirements concerning fair value and, in both cases, gains and losses resulting from recognition at fair value are required to be reported in the profit and loss account. The proposed revision, adding new Articles 42e and 42f, is necessary in order to permit the application of these standards. It is expected that a Member State permitting, and any company adopting, a policy of fair value should do so only in accordance with a recognised, generally accepted accounting system, such as that provided by adopted IAS.

The revision contains a general provision empowering Member States to permit such a treatment for any specified class or classes of asset. This is essential if the revision is to deal adequately with future developments.

To avoid confusion, the terminology in Article 60 of the Directive has been amended from ‘market value’ to ‘fair value’.

Paragraphs 13, 21 and 23 – Reflect consequential changes to references.

Paragraph 14 – The 4th Directive currently includes a requirement for the preparation of an annual report giving ‘at least a fair review of the development of the company’s business and of its position’. The interpretation of this requirement has led to a wide variation of disclosures, ranging from those which help to provide an understanding of the annual accounts to mere ‘boiler plate’ statements. Whilst no change is proposed to the underlying requirement for a ‘fair review’, it is desirable to promote greater consistency in the quality of these reviews and to give additional guidance on the information content expected of a ‘fair review’.

In proposing these amendments, consideration has been given to current best practice, in particular, the recent paper “Management’s analysis of the business” produced by the European Accounting Study Group and to those disclosures anticipated under IAS. The inclusion of detailed provisions has been avoided in order that the requirements do not lead to boiler plate disclosures. This approach will allow additionally for future development in best practice.

Consistent with the Commission Recommendation of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual reports of companies (2001/453/EC)⁹, the provisions require that the information included shall not be restricted to the financial aspects of the company’s business. It is expected that this will lead to an analysis of environmental, social and other aspects relevant to an understanding of the company’s development and position.

Paragraph 15 – Further to the proposed changes to Article 51 of the 4th Directive, see paragraphs 17 and 18 below, the last sentence of Article 48 concerning the disclosure of certain elements of the report of the statutory auditor(s) has been deleted.

Paragraph 16 – This amends the provision of the 4th Directive which deals with the publication of, and references to, the audit report in those instances when extracts from the

⁹ OJ No L156, 13. 6. 2001, p. 33

annual accounts are published. The requirements are amended slightly to reflect current practice, requiring additionally the disclosure of any matters to which the auditor has drawn attention without qualifying the audit report.

Paragraphs 17 and 18 – Standards on auditing, including the preparation and presentation of an ‘audit report’ exist in each Member State. Unfortunately, the interpretation of these standards has not led to the expected degree of harmonisation – resulting in audit reports that differ across Member States. These differences, some of which are significant, reduce comparability and detract from the user’s understanding of this vital element of financial reporting. The changes proposed in respect of the audit report reflect current best practice concerning the format and content of an audit report and will encourage greater harmonisation.

Paragraph 19 – This change updates the Directive further to the introduction of the Euro.

Paragraph 20 – The 4th Directive provides a limited number of exemptions, generally in respect of the obligation to make certain disclosures in the annual accounts, on the basis of the economic importance of the company. It is considered, consistent with the Commission’s proposals in respect of the use of IAS by EU listed companies, that such exemptions should not be available to listed companies, regardless of their economic size. This is a reflection of the overriding economic importance that attaches to the public trading of a company’s shares. Accordingly, this revision removes the availability of the exemptions in the case of such companies.

3.2. Article 2

Further to the objectives set out above, Article 2 makes those changes necessary to the Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts.

Paragraph 1 – Article 1 of the 7th Directive describes those undertakings which are considered to be ‘subsidiary undertakings’ of a parent undertaking. The current provisions acknowledge that an undertaking may be controlled by the exercise of dominant influence (effective control), even in the absence of rights over a majority of the voting rights of the undertaking (ie a legal power of control). However, the current provisions do require a participating interest (as defined in Article 17 of the 4th Directive – broadly a minimum interest in the capital) to exist. Under IAS, an undertaking is a subsidiary undertaking if it is controlled by a parent, irrespective of the existence of an interest in the capital of the undertaking.

The issue has become more important in recent years with the development of legal structures (often referred to as Special Purpose Entities) designed to give the effect of a subsidiary undertaking without giving rise to a subsidiary undertaking under the existing requirements of Article 1. Accordingly, it is considered that the current requirement in the Directive for a participating interest to exist is no longer appropriate and it is therefore proposed to delete it. This brings the Directive into line with IAS requirements.

Paragraphs 2, 4(b), 5, 6, 9 and 10 – The 7th Directive currently requires the exclusion of an undertaking from the consolidated accounts of the parent if its activities are incompatible with those of the parent such that inclusion would fail to meet the requirement to give a true and fair view of the undertakings included therein taken as a whole.

It is now generally accepted that this is never the case. Regardless of the differing activities the appropriate accounting treatment is the inclusion of the undertaking together with suitable

additional disclosure of its impact on the consolidated accounts. Accordingly, this requirement is now considered redundant and has been deleted. This brings the Directive into line with IAS requirements.

Consequential changes have been made to remove references to the deleted requirement.

Paragraphs 3(a), 4(c) and 13 – The 7th Directive provides a limited number of exemptions from its requirements, on the basis of the economic importance of the company. It is now considered, consistent with the Commission's proposals in respect of the use of IAS by EU listed companies, that such exemptions should not be available to listed companies, regardless of their economic size. This is a reflection of the overriding economic importance that attaches to the public trading of a company's shares. Accordingly, these revisions remove the availability of the exemptions in the case of such companies.

Paragraphs 3(b) and 4(a) – These delete defunct time-based provisions.

Paragraph 7 – It is common practice for certain additional statements to be provided in consolidated accounts, for example a cash flow statement. This revision expressly empowers Member States to permit or require such statements be included in consolidated accounts. See also similar amendment in respect of annual accounts in Article 1, paragraph 1.

Paragraph 8 – This makes a consequential change resulting from amendments to the 4th Directive above.

Paragraph 11 – These changes expand the guidance on the content of the consolidated annual report and are consistent with those in Article 1, paragraph 14 above. Where both an annual report and a consolidated annual report are required, it may be appropriate to present the analysis as a single document, the primary focus being upon those matters which are significant to the undertakings included in the consolidation taken as a whole.

Paragraph 12 – These changes relate to the requirements in respect of the audit report concerning the consolidated accounts. The changes are consistent with those set out in Article 1, paragraphs 17 and 18 above.

3.3. Article 3

Further to the objectives set out above, Article 3 makes those changes necessary to make the Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings compatible with IAS.

Most of the changes proposed are consequential to those to the 4th Directive described above.

Additional changes are proposed in order to reflect amendments made in May 2001 by Directive 2001/65/EEC to the 4th, 7th Directives and to Directive 86/637/EEC. These changes relate to the use of fair value in the case of certain specific items further to IAS 39 *Financial Instruments: Recognition and measurement*.

No amendments are currently proposed to the prescribed formats for the balance sheet and profit and loss account of insurance undertakings. Any such changes will be considered and where necessary enacted, only when an International Financial Reporting Standard specifically concerning insurance accounting is published.

Paragraph 1 – The first sentence of Article 1(1) of the Directive 91/674/EEC has been updated to refer to new and amended Articles in the 4th Directive as follows:

- A new reference to Article 51a has been added, consistent with the insertion of this Article 51 into the 4th Directive (see Article 1, paragraph 18);
- A new reference to Articles 42a-42f of the 4th Directive concerning fair value has been added;
- The reference to Article 43 of the 4th Directive has been amended to include also point 14 concerning certain fair value disclosures;
- A new reference to Article 61a of the 4th Directive concerning the revision of the fair value provisions after three years of use (or five years after the adoption of the Directive) has been added.
- Concerning the reference to Article 46, a specification to paragraphs 1 and 2 is added.
- A new reference to Article 50a is added for the sake of completeness.
- The reference to Article 54 has been removed, as this Article no longer exists.

In addition, a new second sentence has been added in relation to financial assets and liabilities. It contains a “double override” provision which specifies that Articles 46 to 48, 51 and 53 of Directive 91/674/EEC shall not apply in respect to assets and liabilities that are valued in accordance with Section 7a of the 4th Directive. The paragraph establishes the hierarchy of rules in Directive 91/674/EEC and the 4th Directive concerning financial instruments and is consistent with the amendment to Directive 86/635/EEC introduced in May 2001 by Directive 2001/65/EEC.

In addition, Article 1(2) has been revised to reflect consequential changes to references.

Paragraph 2 – This paragraph makes a consequential change in terminology.

Paragraph 3 – In order to facilitate full application of IAS 39, an amendment is included in Article 46(5) to enable Member States to allow companies to use different valuation methods for different elements of an investment item denoted by an arabic numeral or shown as assets under C(1) on the balance sheet. An amendment to Article 46(6) requires that, where such different methods are applied, the notes to the accounts include a description of the methods used and the amount so determined.

3.4. Articles 4 to 6 – Final provisions

The provisions in these Articles deal with the adoption and administration of the proposed Directive.

4. OTHER MATTERS

As noted in section 1 above, the proposed amendments will remove all inconsistencies between Directives 78/660/EEC, 83/349/EEC and 91/674/EEC and IAS in existence at 1 May 2002.

This conclusion is supported by a review of the proposals performed by the European Financial Reporting Advisory Group (EFRAG).

In the development of the proposals, a number of accounting topics were considered carefully before concluding that no inconsistency or conflict exists. Where this was the case, no proposal for amendment is necessary and none has been made.

Solely for the avoidance of doubt, it is noted that the following three topics have been considered and it has been determined that no conflict arises with respect to:

- The recognition of actuarial gains and losses in accordance with the so-called ‘corridor approach’ described in IAS 19 *Employee Benefits*.
- The correction of errors as either a prior period adjustment or as a current period item in accordance with IAS 8 *Net profit or loss for the period, Fundamental errors and Changes in Accounting Policies*.
- The application of reverse acquisition accounting in accordance with IAS 22 *Business combinations* – ie where, in a business combination, the owners of a company being acquired receive as consideration sufficient voting shares of the acquiring company so as to obtain control over the new combined entity. In applying reverse acquisition accounting, the company issuing the shares is deemed to have been acquired by the other enterprise; this means that, from an accounting (as opposed to a legal) perspective, the latter enterprise is deemed to be the acquirer, and therefore the purchase method of accounting is applied to the assets and liabilities of the enterprise issuing the shares.

These topics and the conclusions expressed have been discussed and agreed with EFRAG.

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Council Directives 78/660/EEC, 83/349/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies and insurance undertakings

(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 Commission¹,

Having regard to the opinion of the Economic and Social Committee²,

Acting in accordance with the procedure laid down in Article 251 of the Treaty³,

Whereas:

- (1) The Lisbon European Council of 23-24th March 2000 emphasised the need to accelerate completion of the internal market for financial services, set the deadline of 2005 to implement the Commission's Financial Services Action Plan and urged that steps be taken to enhance the comparability of financial statements prepared by Community companies whose securities are listed on a regulated market (hereinafter: "listed companies").
- (2) On 13 June 2000, the Commission published its Communication on "EU Financial Reporting Strategy: The Way Forward"⁴ in which it was proposed that all listed companies prepare their consolidated accounts in accordance with one single set of accounting standards, namely International Accounting Standards (IAS), at the latest by 2005.
- (3) Regulation (EC) No [.../...] of the European Parliament and of the Council [...] on the application of international accounting standards⁵ (hereinafter: "the IAS Regulation") introduced the requirement that, from 2005 onwards, all listed companies prepare their consolidated accounts in accordance with IAS adopted for application within the Community. It also provided an option for Member States to permit or require the application of adopted IAS in the preparation of annual accounts and to permit or require the application of adopted IAS by unlisted companies.

¹ OJ C [...], [...], p. [...].

² OJ C [...], [...], p. [...].

³ OJ C [...], [...], p. [...].

⁴ COM (2000)359, 13.06.2000

⁵ OJ L ..., p ...

- (4) The IAS Regulation provides that to adopt an international accounting standard for its application in the Community, it is necessary that it meets the basic requirement of 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 companies⁶ and of Council Directive 83/349/EEC of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts⁷, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise; this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of those Directives.
- (5) As the annual and consolidated accounts of undertakings covered by Directive 78/660/EEC and Directive 83/349/EEC which are not prepared in accordance with the IAS Regulation will continue to have those Directives as the primary source of their Community accounting requirements, it is important that a level playing field exist between Community companies which apply IAS and those which do not.
- (6) For the purposes both of the adoption of IAS and the application of Directive 78/660/EEC and Directive 83/349/EEC, it is desirable that those Directives reflect developments in international accounting. In this respect, the Communication of the Commission on “Accounting Harmonisation: A New Strategy vis-à-vis International Harmonisation”⁸ called for the European Union to work to maintain consistency between Community Accounting Directives and developments in international accounting standard setting, in particular within the International Accounting Standards Committee (IASC).
- (7) The annual report and the consolidated annual report are important elements of financial reporting. Enhancement, in line with current best practice, of the existing requirement for these to present a fair review of the development of the business and of its position is necessary to promote greater consistency and give additional guidance on the information content expected of a ‘fair review’. The information should not be restricted to the financial aspects of the company’s business. It is expected that this will lead to an analysis of environmental, social and other aspects relevant to an understanding of the company’s development and position. This is consistent also with the Commission Recommendation 2001/453/EC of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual reports of companies⁹,
- (8) Differences in the preparation and presentation of the ‘audit report’ reduce comparability and detract from the user’s understanding of this vital aspect of financial reporting. Increased consistency is achieved by amendments, consistent with current international best practice, to the specific requirements concerning the format and content of an audit report.
- (9) Directive 78/660/EEC and Directive 83/349/EEC should accordingly be amended. Consequently, it is also necessary to amend Council Directive 91/674/EEC of 19

⁶ OJ No L222, 14. 8. 1978, p. 11, Directive as last amended by Directive 2001/65/EEC (OJ No L283, 27. 10. 2001, p. 28)

⁷ OJ No L193, 18. 7. 1983, p. 1, Directive as last amended by Directive 2001/65/EEC (OJ No L283, 27. 10. 2001, p. 28)

⁸ COM 1995(508), 14.11.1995

⁹ OJ No L156, 13. 6. 2001, p. 33

December 1991 on the annual and consolidated accounts of insurance undertakings¹⁰. These amendments will remove all inconsistencies between Directive 78/660/EEC, Directive 83/349/EEC and Directive 91/674/EEC and IAS in existence at 1 May 2002.

HAVE ADOPTED THIS DIRECTIVE:

Article 1

Directive 78/660/EEC is amended as follows:

- (1) In Article 2(1) the following subparagraph is added:

“Member States may allow or require the inclusion of other statements in the annual accounts in addition to the documents referred to in the first paragraph.”
- (2) In Article 4 the following paragraph 6 is added:

“6. Member States may allow or require that the presentation of amounts within items in the profit and loss account and balance sheet shall have regard to the substance of the reported transaction or arrangement. Such permission or requirement may be restricted to certain classes of company or to consolidated accounts as defined in Council Directive 83/349/EEC*.

* OJ No L 126, 12.05.1984, p.20”
- (3) In Article 8 the following paragraph is added:

“Member States may allow or require companies to adopt the presentation of the balance sheet set out in Article 10a as an alternative to those otherwise prescribed or permitted.”
- (4) In Article 9, under ‘Liabilities’, in point B the title “Provisions for liabilities and charges” is replaced by “Provisions”.
- (5) In Article 10, point J, the title “Provisions for liabilities and charges” is replaced by “Provisions”.
- (6) the following Article 10a is inserted:

“Article 10a

Instead of the presentation of balance sheet items in accordance with Articles 9 and 10, Member States may allow or require companies, or certain classes of companies, to present those items based upon a distinction between current and non-current items provided that the information content given is at least equivalent to that otherwise required by Articles 9 and 10.”
- (7) Article 20 is amended as follows:
 - (a) Paragraph 1 is replaced by the following:

¹⁰ OJ No L374, 31. 12. 1991, p. 7

“Provisions are intended to cover liabilities the nature of which is clearly defined and which at the date of the balance sheet are either likely to be incurred, or certain to be incurred but uncertain as to amount or as to the date on which they will arise.”

(b) Paragraph 3 is replaced by the following:

“Provisions may not be used to adjust the values of assets.”

(8) In Article 22, the following paragraph is added:

“By way of derogation from Article 2(1), Member States may allow or require all companies, or any classes of companies, to present a statement of their performance instead of the presentation of profit and loss items in accordance with Articles 23 to 26, provided that the information content given is at least equivalent to that otherwise required by those Articles.”

(9) Article 31 is amended as follows:

(a) In paragraph 1(c), the point (bb) is replaced by the following:

“account must be taken of all liabilities arising in the course of the financial year concerned or of a previous one, even if such liabilities or losses become apparent only between the date of the balance sheet and the date on which it is drawn up,”

(b) The following paragraph 1a is inserted:

“1a. In addition to those amounts recorded further to Article 31(1)(c)(bb), Member States may permit or require account to be taken of all foreseeable liabilities and potential losses arising in the course of the financial year concerned or of a previous one, even if such liabilities or losses become apparent only between the date of the balance sheet and the date on which it is drawn up.”

(10) In Article 33(1), the point (c) is replaced by the following:

“revaluation of fixed assets”

(11) In Article 42, the first paragraph is replaced by the following:

“Provisions may not exceed in amount the sums which are necessary.”

(12) The following Articles 42e and 42f are inserted:

“Article 42e

By way of derogation from Article 32, Member States may permit or require in respect of all companies or any classes of companies the valuation of specified categories of assets other than financial instruments at amounts determined by reference to fair value.

Such permission or requirement may be restricted to consolidated accounts as defined in Directive 83/349/EEC.

Article 42f

Notwithstanding Article 31(1)(c), Member States may permit or require in respect of all companies or any classes of companies that, where an asset is valued in accordance with Article 42e, a change in the value shall be included in the profit and loss account.”

- (13) In Article 43(1)(6) the reference to “Articles 9 and 10” is replaced by a reference to “Articles 9, 10 and 10a”.

- (14) Article 46 is amended as follows:

(a) Paragraph 1 is replaced by the following:

“The annual report must include at least a fair review of the development of the company’s business and of its position.

The review shall include a balanced and comprehensive analysis of the development of the company’s business and of its position. The information included shall not be restricted to the financial aspects of the company’s business.

In providing its analysis, the annual report shall, where appropriate, include references to and additional explanations of amounts reported in the annual accounts.”

(b) In paragraph 2, point (b) is replaced by the following:

“the company’s likely future development including any significant uncertainties and risks which may affect that development;”

- (15) In Article 48, the third sentence is deleted.

- (16) In Article 49, the third sentence is replaced by the following:

“The report of the person or persons responsible for auditing the annual accounts (hereinafter: “the statutory auditors”), may not accompany this publication, but it must be disclosed whether the audit opinion was issued with or without qualification, or whether the statutory auditors were unable to express an audit opinion. It shall also be disclosed whether the report of the statutory auditors included a reference to any matters by way of emphasis to which the statutory auditors drew attention without qualifying the audit opinion.”

- (17) Article 51(1) is replaced by the following:

“The annual accounts of companies shall be audited by one or more persons approved by Member States to carry out statutory audits on the basis of Directive 84/253/EEC*.

The statutory auditors must also verify that the annual report is consistent with the annual accounts for the same financial year.

* OJ No L 126, 12.05.1984, p.20”

- (18) The following Article 51a is inserted:

“Article 51a

1. The report of the statutory auditors shall include:

(a) an introduction which shall at least identify the annual accounts which are the subject of the statutory audit;

(b) a description of the scope of the statutory audit which shall at least identify the auditing standards in accordance with which the statutory audit was conducted;

(c) an audit opinion which shall state clearly the opinion of the statutory auditors as to whether the annual accounts give a true and fair view in accordance with the relevant financial reporting framework and, where appropriate, whether the annual accounts comply with statutory requirements; the audit opinion shall be either unqualified, qualified, an adverse opinion or, if the statutory auditors are unable to express an audit opinion, a disclaimer of opinion;

(d) a reference to any matters to which the statutory auditors draw attention by way of emphasis without qualifying the audit opinion.

(e) an opinion concerning the consistency or otherwise of the annual report with the annual accounts for the same financial year.

2. The report shall be signed and dated by the statutory auditors.”

(19) Article 53(1) is deleted.

(20) The following Article 53a is inserted:

“Article 53a

Member States shall not make available the exemptions set out in Articles 11, 27, 46, 47 and 51 in the case of companies whose securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC*.

* OJ L 141 , 11.06.1993 p.27”

(21) In Article 56(1) the reference to “Articles 9, 10” is replaced by a reference to “Articles 9, 10, 10a”.

(22) In Article 60, first paragraph, the words “on the basis of their market value” are replaced by “on the basis of their fair value”.

(23) In Article 61a, the reference to “Articles 42a to 42d” is replaced by a reference to “Articles 42a to 42f”.

Article 2

Directive 83/349/EEC is amended as follows:

(1) In Article 1, paragraph 2 is replaced by the following:

“Apart from the cases mentioned in paragraph 1, the Member States may require any undertaking governed by their national law to draw up consolidated accounts and a consolidated annual report if:

(a) that undertaking (a parent undertaking) actually exercises dominant influence over another undertaking (the subsidiary undertaking); or

(b) that undertaking (a parent undertaking) and another undertaking (the subsidiary undertaking) are managed on a unified basis by the parent undertaking.”

(2) In Article 3(1), the reference to “Articles 13, 14 and 15” is replaced by a reference to “Articles 13 and 15”.

(3) Article 6 is amended as follows:

(a) Paragraph 4 is replaced by the following:

“This Article shall not apply where one of the undertakings to be consolidated is a company whose securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Council Directive 93/22/EEC*.

* OJ L 141 , 11.06.1993 p.27”

(b) Paragraph 5 is deleted.

(4) Article 7 is amended as follows:

(a) In paragraph 1(b), the second subparagraph is deleted.

(b) In paragraph 2(a), the reference to “Articles 13, 14 and 15” is replaced by a reference to “Articles 13 and 15”.

(c) Paragraph 3 is replaced by the following:

“A Member State may not apply paragraphs 1 and 2 to companies whose securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Directive 93/22/EEC.”

(5) In Article 11(1)(a) the reference to “Articles 13, 14 and 15” is replaced by a reference to “Articles 13 and 15”.

(6) Article 14 is deleted.

(7) in Article 16(1) the following subparagraph is added:

“Member States may allow or require the inclusion of other statements in the consolidated accounts in addition to the documents referred to in the first paragraph.”

(8) In Article 17(1) the reference to “Articles 3 to 10” is replaced by a reference to “Articles 3 to 10a”.

(9) In Article 34(2)(b) the terms “Articles 13 and 14 and, without prejudice to Article 14(3),” are replaced by a reference to “Article 13 and”.

(10) In Article 34(5) the words “and those excluded pursuant to Article 14” are deleted.

(11) Article 36 is amended as follows:

(a) Paragraph 1 is replaced by the following:

“1. The consolidated annual report must include at least a fair review of the development of the business and the position of the undertakings included in the consolidation taken as a whole.

The review shall include a balanced and comprehensive analysis of the development of the business and of its position. The information included shall not be restricted to the financial aspects of the business.

In providing its analysis, the consolidated annual report shall, where appropriate, provide references to and additional explanations of amounts reported in the consolidated accounts.”

(b) In paragraph 2, point b is replaced by the following:

“(b) the likely future development of those undertakings taken as a whole including any significant uncertainties and risks which may affect that development;”

(c) The following paragraph 3 is added:

“3. Where a consolidated annual report is required in addition to an annual report, the two reports may be presented as a single report. In preparing such a single report, it may be appropriate to give greater emphasis to those matters which are significant to the undertakings included in the consolidation taken as a whole.”

(12) Article 37 is replaced by the following:

“1. The consolidated accounts of companies shall be audited by one or more persons approved by the Member State whose laws govern the parent undertaking to carry out statutory audits on the basis of Council Directive 84/253/EEC*.

The report of the person or persons responsible for auditing the consolidated accounts (hereinafter: “the statutory auditors”) must also verify that the consolidated annual report is consistent with the consolidated accounts for the same financial year.

2. The report of the statutory auditors shall include:

(a) an introduction which shall at least identify the consolidated accounts which are the subject of the statutory audit;

(b) a description of the scope of the statutory audit which shall at least identify the auditing standards in accordance with which the statutory audit was conducted;

(c) an audit opinion which shall state clearly the opinion of the statutory auditors as to whether the consolidated accounts give a true and fair view in accordance with the relevant financial reporting framework and, where appropriate, whether the consolidated accounts comply with statutory requirements; that audit opinion shall be

either unqualified, qualified, an adverse opinion or, if the statutory auditor is unable to express an audit opinion, a disclaimer of opinion;

(d) a reference to any matters to which the statutory auditors draw attention by way of emphasis without qualifying the audit opinion;

(e) an opinion concerning the consistency or otherwise of the consolidated annual report with the consolidated accounts for the same financial year.

3. The report shall be signed and dated by the statutory auditors.

4. In the case where the annual accounts of the parent undertaking are attached to the consolidated accounts, the report of the statutory auditors required by this Article may be combined with any report of the statutory auditors on the annual accounts of the parent undertaking required by Article 51 of Directive 78/660/EEC.

* OJ No L 126, 12.05.1984, p.20”

(13) In Article 38, the following paragraph 7 is added:

“7. Paragraphs 2 and 3 of this Article shall not be applied in respect of companies whose securities are admitted to trading on a regulated market of any Member State within the meaning of Article 1(13) of Directive 93/22/EEC.”

Article 3

Directive 91/674/EEC is amended as follows:

(1) In Article 1, paragraphs 1 and 2 are replaced by the following:

"1. Articles 2, 3, 4(1), (3) to (5), 6, 7, 13, 14, 15(3) and (4), 16 to 21, 29 to 35, 37 to 41, 42, 42a to 42f, 43(1), points 1 to 7 and 9 to 14, 45(1), 46(1) and (2), 48 to 50, 50a, 51(1), 51a, 56 to 59, 61 and 61a of Directive 78/660/EEC shall apply to the undertakings mentioned in Article 2 of this Directive, except where this Directive provides otherwise. Articles 46, 47, 48, 51 and 53 of this Directive shall not apply in respect to assets and liabilities that are valued in accordance with Section 7a of Directive 78/660/EEC.

2. Where reference is made in Directives 78/660/EEC and 83/349/EEC to Articles 9, 10 and 10a (balance sheet) or to Articles 22 to 26 (profit and loss account) of Directive 78/660/EEC, such references shall be deemed to be references to Article 5 (balance sheet) or to Article 29 (profit and loss account) of this Directive as appropriate.”

(2) In Article 6, under “Liabilities”, in point E, the title “Provisions for other risks and charges” is replaced by “Other provisions”.

(3) Article 46 is amended as follows:

(a) In paragraph 5, the following subparagraph is added:

“Member States may permit derogations from the first subparagraph.”

(b) Paragraph 6 is replaced by the following:

“The method(s) applied to each investment item shall be stated in the notes to the accounts, together with the amounts so determined.”

Article 4

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by [...] at the latest. They shall forthwith inform the Commission thereof.

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.

Article 5

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

Article 6

This Directive is addressed to the Member States.

Done at Brussels, [...]

For the European Parliament
The President
[...]

For the Council
The President
[...]

LEGISLATIVE FINANCIAL STATEMENT

Policy area(s): Internal Market

Activit(y/ies): Financial reporting

TITLE OF ACTION: PROPOSAL FOR A DIRECTIVE AMENDING THE COUNCIL DIRECTIVES 78/660/EEC, 83/349/EEC AND 91/674/EEC

1. BUDGET LINE(S) + HEADING(S)

None

2. OVERALL FIGURES

2.1. Total allocation for action (Part B): € million for commitment

No impact.

2.2. Period of application:

N/A

2.3. Overall multiannual estimate on expenditure:

N/A

2.4. Compatibility with the financial programming and the financial perspective

N/A

2.5. Financial impact on revenue:

N/A

3. BUDGET CHARACTERISTICS

N/A

4. LEGAL BASIS

Article 44(2)(g) of the EC Treaty.

5. DESCRIPTION AND GROUNDS

5.1. Need for Community intervention

Council Directives 78/660/EEC, 83/349/EEC and 91/674/EEC (together ‘the Accounting Directives’) have remained largely unchanged since their issue as much as 23 years ago. In this period accounting theory and accepted practice have developed significantly and continue to do so.

Numerous studies have been prepared or received by the Commission which indicate that, in many respects, the Accounting Directives remain consistent with current accounting theory and practice. However, in certain limited areas, their requirements are incompatible with International Accounting Standards (IAS) which the EU will seek to adopt further to the IAS Regulation¹. This situation is unacceptable for two reasons:

Firstly, if the Accounting Directives are to play an important role in the mechanism for adopting IAS under the proposed IAS Regulation, they must reflect current accounting developments.

Secondly, there must be a level playing field between companies which apply IAS and those which do not.

The objectives of this proposal are therefore threefold:

- (1) To remove all conflicts between the Accounting Directives and IAS;
- (2) To ensure that optional accounting treatments currently available under IAS are available to EU companies which continue to have the Accounting Directives as the basis of their accounting legislation (i.e. those companies which do not prepare their annual or consolidated accounts in accordance with adopted IAS further to the IAS Regulation); and
- (3) To update the fundamental structure of the Accounting Directives so that they provide a framework for financial reporting that is both consistent with modern practice and flexible enough to allow for future developments.

In achieving these objectives, the proposals are designed to allow Member States to amend their national accounting requirements in respect of companies subject to the Accounting Directives in a manner and at a pace appropriate to national circumstances. This is achieved by the introduction of additional accounting requirements by way of Member State options and no reduction of accounting options available at present.

Accordingly, the proposals will have no accounting impact other than that deemed appropriate by individual Member States. This is considered essential due the interaction of accounting requirements with fiscal and other areas, notably in the case of annual accounts.

5.2. Actions envisaged and arrangements for budget intervention

N/A

¹ COM (2001)80

5.3. Methods of implementation

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with these Directives. They shall forthwith inform the Commission thereof.

6. FINANCIAL IMPACT

No impact.

7. IMPACT ON STAFF AND ADMINISTRATIVE EXPENDITURE

The necessary human and administrative resources will be covered within the budgetary allocation attributed to the managing DG.

8. FOLLOW-UP AND EVALUATION

When Member States adopt these new provisions, they shall contain a reference to these Directives or be accompanied by such a reference on the occasion of their official publication. They shall forthwith inform the Commission thereof.

9. ANTI-FRAUD MEASURES

Given the nature of the action, no specific fraud prevention measures are necessary.

IMPACT ASSESSMENT FORM

THE IMPACT OF THE PROPOSAL ON BUSINESS WITH SPECIAL REFERENCE TO SMALL AND MEDIUM-SIZED ENTERPRISES(SMEs)

I. TITLE OF PROPOSAL

Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC, 83/349/EEC and 91/674/EEC (together 'the Accounting Directives').

II. DOCUMENT REFERENCE NUMBER

COM(2002)259

III. THE PROPOSAL

1. It is proposed to amend the Accounting Directives to bring them in line with current international theory and practice. The objectives and proposals are explained more fully at point 5 of the Legislative Financial Statement above.

IV. THE IMPACT ON BUSINESS

2. Who will be affected by the proposal?

The precise scope of the existing Accounting Directives is stated in detail in those Directives. The proposals do not amend the scope of those Directives. Accordingly, the proposals will affect entities falling within the scope of the existing Accounting Directives, i.e. all entities that prepare their consolidated and/or annual accounts in accordance with the Accounting Directives.

3. What will business have to do to comply with the proposal?

The proposals are designed to allow Member States to amend their national accounting requirements derived from those Accounting Directives in respect of these companies in a manner and at a pace appropriate to national circumstances. This is achieved by the introduction of additional accounting requirements by way of Member State options and no reduction of accounting options available at present. Accordingly, the proposals will have no accounting impact other than that deemed appropriate by individual Member States. This is considered essential due the interaction of accounting requirements with fiscal and other areas, in particular in the case of annual accounts.

In addition to the consolidated (and/or annual) accounts, the Accounting Directives have previously required companies above a certain size to produce a consolidated (and/or annual) report giving a fair review of the business. In the proposal, this requirement has been retained and enhanced in line with current best practice. This will result in a more comprehensive report including information relevant to a wider group of stakeholders – ie it shall not be limited solely to financial aspects of the business.

It is expected that this Directive should be adopted by Council and Parliament at the latest in 2002. As these proposals are associated with the proposals for the use of IAS in the consolidated accounts of certain listed companies from 2005 onwards, this will provide Member States, companies and the accounting profession a reasonable transition period to

prepare themselves before the implementation of the proposal for the use of IAS from 2005. Such preparation may necessarily include the recalculation of amounts reported prior to 2005 in accordance with new requirements where these amounts affect either opening balances under the revised requirements or comparatives reported in periods to which the revised requirements are applied.

As noted above, the proposals *require* very few changes being designed (by the use of Member State options) to allow Member States to amend their national accounting requirements derived from those Accounting Directives in respect of these companies in a manner and at a pace appropriate to national circumstances. Any additional costs for companies will be dependent mainly upon the extent to which Member States introduce changes in implementing the Member State options in the proposals. Those costs which arise will generally be in the area of training staff to deal with any revised accounting requirements.

4. What economic effects is the proposal likely to have?

The proposal to update the Accounting Directives will provide a framework for financial reporting that will enhance the comparability and transparency of financial information, thereby increasing the efficiency of the markets and reducing the cost of capital for companies.

5. Does the proposal contain measures to take account of the specific situation of small and medium-sized firms (reduced or different requirements etc)?

As noted above, the proposals are designed to allow Member States to amend their national accounting requirements derived from those Accounting Directives in a manner and at a pace appropriate to national circumstances. Accordingly, the proposals will have no accounting impact other than that deemed appropriate by individual Member States.

A number of derogations already exist in respect of entities which are below certain size criteria included in Articles 11 and 27 of the Fourth Directive (78/660/EEC). These lessen the burden of disclosure for such companies and remain appropriate. It is not proposed to amend the existing derogations or the size thresholds at which they are available, other than to require that they are not available to listed companies. This is a necessary clarification, consistent with the proposal for the use of IAS by such companies, which will have no effect in practice as listed companies would almost certainly be too large to meet the basic criteria in any event.

V. CONSULTATION

6. The proposals have been discussed in the Contact Committee and received wide support.

In addition, the Technical Expert Group of EFRAG (European Financial Reporting Advisory Group) has considered the proposals and confirmed that they achieve their primary objective of removing all conflicts between the Accounting Directives and IASs in issue at 1 May 2002.

EFRAG comprises a Technical Expert Group and a Supervisory Board. The Technical Expert Group represents the main private sector groups closely involved in financial reporting, namely the European accounting professions, stock exchanges, financial analysts and companies preparing accounts (including credit institutions and insurers). The EFRAG Supervisory Board monitors the work of the Technical Expert Group and assures that the individual members work in the European interest.

The involvement in EFRAG of the experts from European organisations is the best guarantee that the European interest will be considered properly. These organisations are: FEE (accounting profession), UNICE (industry), ECSAs (banking), CEA (insurance), FESE (stock exchanges), EFFAS (financial analysts), EFAA (auditors for small and medium-sized enterprises) and UEAPME (small and medium-sized enterprises).