

BACKGROUND NOTE

11 July 2007: The European Commission's Communication on simplification of EU rules on company law, accounting and auditing.

1. OUTLINE OF THE COMMISSION'S EXPECTED COMMUNICATION

- The Commission seeks stakeholders' views on a range of possible simplification measures ranging from:
 - repealing Company law Directives that deal mainly with domestic situations, or;
 - removing instead certain information obligations in the company law Directives;
 - simplifying disclosure requirements for companies and for branches,
 - Further reducing reporting and auditing requirements for small and medium enterprises.

2. BACKGROUND INFORMATION

2.1: General context of 'better regulation' and 'simplification'

- **Better Regulation** is a centrepiece of the European Commission's "Partnership for Growth and Jobs" - the renewed '**Lisbon Strategy**' launched in spring 2005. For the European Commission Better Regulation is about maximising the benefits of legislation (ensuring a fair and competitive market place, citizen's welfare and the effective protection of public health and the environment) whilst minimising its costs. It consists of three elements:
 - Withdrawal or modification of pending proposals (in case of adverse effects on competitiveness or lack of relevance or of political support)
 - Better quality of new Commission proposals (improved impact assessment which includes assessing the intended and unintended, social, economic and environmental, impacts of policy options)
 - Simplification of existing EU-law.

- Regarding **simplification**, the Commission defined a programme to simplify and modernise existing legislation in 2005 with an initial batch of about 100 simplification initiatives. In November 2006, the Commission published a Communication "*A Strategic Review of Better regulation in the EU*", extending progressively the scope of the simplification exercise to all EU policy areas, and issued a working document on measuring costs and reducing administrative burdens in the European Union.
- In January 2007, the European Commission presented an **Action Programme to cut unnecessary administrative burdens**¹, as one of the key objectives of Commission President Barroso and Vice President Verheugen. The stated target is to cut administrative burdens on businesses by 25% by 2012. The Programme focuses on information obligations in thirteen priority areas.
- The Action Programme is based on the **Standard Cost Model (SCM)** methodology which is an attempt to measure the cost of administrative burdens²; however, FEE notes that this methodology only looks at the cost and does not take into account any of the benefits that may be associated to these costs and may compensate or offset them.

2.2: Simplification in the field of company law, accounting and auditing

- On 14 June 2006, Directive 2006/46/EC amending the Fourth and Seventh Company Law Directives raised the **thresholds** above which the Member States may exempt companies from certain requirements by 20 percent. The effect of this Directive is still unknown as it has to be implemented by 5 September 2008 and some Member States have already indicated that they will not opt to implement the option.
- In addition, **DG Internal Market and Services** has announced its intention to revise the accounting *acquis* with a view to simplify and update the Fourth and Seventh Company Law Directives for small and medium sized enterprises.
- On 21 March 2007, **FEE** provided a detailed technical analysis³ of two working papers of the European Commission, "*Simplification of accounting rules for small and medium-sized companies – Discussion of possible amendments to the Fourth and Seventh Company Law Directives*" and

¹ COM(2007) 23 final.

² The SCM rests on the following equation: Cost per administrative activity = Price x Time x Quantity (population x frequency). Administrative costs mean the costs incurred by enterprises or citizens in meeting legal obligations to provide information on their activities, either to public authorities or to private parties. They are different from compliance costs which stem from the generic requirements of the legislation.

³ FEE's position on EC Simplification project with a Focus on Financial reporting and Auditing Aspects

"*Making an SME Audit Simpler and more Relevant, basis for discussion (draft)*" respectively issued in December 2006 and January 2007. **FEE** outlined the following preliminary conclusions:

- Policy initiatives in the financial reporting and auditing sphere will have a significant impact on the EU economy: for this reason they must be pursued with great care on the basis of a thorough impact assessment. The costs and the benefits of both the current requirements and the envisaged simplifications have to be assessed and all the consequences of policy initiatives carefully weighed to arrive at net costs or net benefits.
- Most of the changes envisaged in December 2006 and January 2007 to simplify the accounting and auditing rules for SMEs are unlikely to result in any substantial cost savings or reductions in administrative burdens. Real life experience shows that the main burdens imposed on companies are not in the financial reporting area, but rather in other areas such as:
 - overlapping requirements for different regulatory purposes such as tax, incorporation, employment and statistics;
 - tax returns (corporate tax, indirect tax, local taxes, including property taxes);
 - dividend distribution requirements;
 - health and safety legislation and returns;
 - administration of miscellaneous social security programs (calculation, payment and statistical reporting to authorities);
 - the frequency of reporting requirements in certain countries, and;
 - the insufficient use of electronic reporting to avoid double reporting.
- Referring to the Exposure Draft "IFRS for SMEs" of the IASB (the draft accounting standard for non-public interest entities proposed by the International Accounting Standards Board in February), FEE highlighted the importance for all European and national organisations with an interest in financial reporting to comment on the exposure draft clearly indicating what needs to be changed in order to make the proposed standard suitable for use at European (or national) level.
- Furthermore, FEE outlined the **benefits of accounting and auditing** that provide added value to a wide range of stakeholders: managers, business partners, bankers, creditors, investors, employees, trade unions, and public administrations.

- The accounting and audit profession also plays a key role in providing the transparency required by market participants, which reduces the costs of capital and helps markets work better and also safeguards the public interest.
- Accounting is an essential facilitator of cross-border trade. There is a need for more internationally comparable and harmonised financial statements, especially for medium sized and large non-listed companies, because of increasing cross border operations, mergers and acquisitions involving companies in different Member States. Accounting and auditing requirements support the development and the integration of new economies into the EU and contribute to the dissemination of best practices.
- SMEs often do not have strong financial expertise in-house so rely on independent external input received from professional accountants to improve financial and management controls that also contribute to preventing risks of failures and fraud. Reporting and related audit, enhancing the quality of the reporting, provides transparency and helps SMEs to get access to finance.

2.3: Standpoints of other stakeholders

- In the Action Programme, the Commission outlined that data from several Member States suggest that a minor part of the cost originate from EU legislation and concluded that *"it is evident that a considerable amount of costs originate at national level"*. It therefore called on the **European Council and the Member States** to endorse the Action Programme and set a joint reduction target for administrative burdens, caused by EC and national legislation of 25% overall, to be achieved by 2012. However, in its meeting of 8-9 March 2007, the European Council only admitted that *"administrative burdens arising from EU legislation should be reduced by 25 % by 2012"* and the Member States did not commit to any specific targets.
 - The **Competitiveness Council** meeting of 19 February 2007 recognised the importance of information obligations as set out in its press release, page 8 on an action plan for reducing administrative burdens *"It is clear that these measures should not compromise the underlying purpose of the legislation or the need to protect the Community's financial interests and ensuring sound financial management, information obligations will remain necessary."*
 - In Belgium, an opinion of the "Conseil Central de l'Economie" on the simplification of the accounting rules for SMEs expressed particular concerns regarding the risks of reducing the quality and accessibility of financial information⁴.

⁴ See opinion of the Belgian "Conseil Central de l'Economie" (CCE) of 30 January 2007 on the simplification of the accounting rules for SMEs and the possible amendment of the accounting directives. The CCE is composed

- In several instances⁵, the **European Parliament** has noted that "*the strategy for a 25 % reduction refers to needless administrative burdens for undertakings and cannot, therefore, be equated to a deregulation; calls on the Commission to ensure that the reduction in needless administrative burdens arising from the regulations should not be at the expense of the original objectives of the regulations concerned*".
- UEAPME, the representative organisation of European **small and medium sized enterprises**, has outlined that SMEs are also important users of financial information and that "*in the context of the simplification of accounting rules for SMEs, it is important that rigorous impact assessments are carried out, including the assessment of the benefits of financial reporting as well as cost/administrative burdens. This should include consideration of why financial reporting requirements were initially imposed and the interest, in terms of stakeholders, that they protect*"⁶.

3: NEXT STEPS

- FEE will now examine carefully the Commission's proposals with the view to helping the Commission's identify the real opportunities in order to reduce administrative costs without hindering the public interest; the Commission will carry out full and comprehensive impact assessments.
- Comments on the proposals are expected by mid- October 2007.

of socio-economic representatives (undertakings, trade unions and SMEs' associations). See also Trends, 1st June 2007, *Le dépôt des comptes à la BNB remis en cause par l'Europe*.

⁵ See for instance (draft) Report of MEP Bert Doorn on better law making 2006/2279.

⁶ UEAPME Comments and observations on the discussion paper of DG Internal Market on the simplification of accounting rules for SMEs, February 2007.