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COMMISSION STAFF WORKING DOCUMENT

Accompanying document to the

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

amending Council Directive 78/660/EEC on the annual accounts of certain types of companies as regards micro-entities

Summary of the Impact assessment

{COM(2009) 83}
{SEC(2009) 206}

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EXECUTIVE SUMMARY

1. INTRODUCTION

This impact assessment presents the Commission's initiatives to simplify the business environment and particularly the financial reporting requirements for micro-entities. It describes the problems related to the current Accounting Directives[1], presents a number of policy options, analyses their feasibility and, where applicable, their expected impacts.

1.1. European Economic Recovery Plan

In accordance with the goals of Lisbon Agenda, the Commission is committed to release the growth potential of the small and medium-sized enterprises companies by reducing their administrative burden.

In the aftermath of the financial crisis, the Commission issued "A European Economic Recovery Plan" to restore consumer and business confidence. The European Economic Recovery Plan pledges to reduce the burden on SMEs and micro-enterprises by among others "removing the requirement on micro-enterprises to prepare annual accounts".

1.2. Policy Context

The aim of the proposals of the Commission that are discussed in this document is to reduce unnecessary administrative obligations and facilitate alignment of reporting requirements to real needs of users and of preparers.

1.3. The EU acquis in company law, accounting and auditing

In the field of accounting the Fourth Company Law Directive establishes minimum requirements for the annual accounts of limited-liability companies. In the time when Accounting Directives were developed the prevailing idea was that SMEs are not fundamentally different from large companies and should follow similar reporting requirements. This view has subsequently changed with acknowledgment of distinct needs of the SME group – laid down as the "think small first" principle. It is important to consider which requirements should be removed or replaced in order to simplify financial reporting for micro-entities[2].

1.4. Definition of micro entities

The Commission category of micro entities is set as the smallest enterprises with the following definition:

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[1] Fourth Council Directive of 25 July 1978 (78/660/EEC);
Seventh Council Directive of 13 June (83/349/EEC)

[2] The Seventh Company Law Directive does not need to be amended, as already the present text of this Directive gives the Member States an option to exclude from the obligation to draw up consolidated financial statements companies which together do not exceed the limits of medium-sized company as defined in the 4th Company Law Directive (Art. 6(1) of the 7th Company Law Directive).

– less than ten employees,

– balance sheet total below 500,000 EUR, and

– turnover below 1,000,000 EUR.

1.5. Practices in the main trading partners of the European Union

In other economically comparable jurisdictions and key trading partners of the European Union, the financial reporting requirements for small companies are generally less demanding than the requirements of the Accounting Directives.

For example in the USA, there is generally no legal obligation to prepare or publish financial statements for unlisted companies. There is no evidence that these less stringent requirements would be a hindrance to US companies in obtaining external financing.

1.6. Opinion of the Commission's Impact Assessment Board

This Impact Assessment takes into consideration the Commission's Impact Assessment Board's comments provided on 2 February 2009.

2. PROCEDURAL ISSUES, CONSULTATION OF INTERESTED PARTIES AND SUBSIDIARITY

The Commission has already taken a number of simplification initiatives to reduce the administrative burden for small and medium-sized companies (SMEs).

2.1. Commission Communication of 10 July 2007 and stakeholder consultation

In 2005, the Commission launched a programme for measuring administrative costs and to identify the most burdensome requirements with a view to reducing administrative burdens for EU companies. The Commission published a communication in July 2007 identifying potential amendments/changes to the Accounting Directives.

In this communication the Commission proposed to introduce a new category of so-called "micro entities" in the Fourth Directive, which could be optionally exempted by Member States from the Accounting Directives.

In all, 18 Member States' governments, the government of one EEA country and 110 stakeholders, including European bodies and associations, reacted to the Communication. These contributions originated from 23 countries in total, including 22 Member States.

80% of all stakeholders who responded to the public consultations took either a positive or negative stance to the measure. The majority was in favour of exempting micro entities from the requirements of the accounting Directives. The exemption was supported by the majority of the companies, public authorities, banks and insurance companies that participated in the survey. The biggest opposition came from accountants and auditors.

2.2. Measurement of cost and thresholds for micro-entities

In connection with the aforementioned simplification initiative, a measurement exercise was carried out by the consortium Capgemini/Ramboll to determine the costs created by the information obligations (IOs) contained in the EU company law acquis. Relevant pre-final results of the measurement exercise are referred to in this impact assessment.

2.3. High Level Group on Administrative Burden Reduction

A report from The High Level Group of Independent Stakeholders on Administrative Burdens (HLG), which reflected on the core obstacles for small firms, calls for rapid enactment of a Member State option to exempt micro entities and a general overhaul of the Accounting Directive with "think small first" as guiding principle.

2.4. European Parliament

The European Parliament's resolution of 18 December 2008 calls on the Commission to come forward with a legislative proposal that allows Member States to exempt very small undertakings (micro entities) from the scope of the Accounting Directives.

2.5. Other related Commission's proposals

In late 2007, the Commission launched a Fast Track legislative action to introduce two technical changes to the Accounting Directives. Adoption is expected in the beginning of 2009.

2.6. Subsidiarity

Following the principle of subsidiarity, it needs to be considered whether EU level harmonisation is for micro entities is really necessary. Most obligations entailing administrative burdens derive from EU directives and their reduction needs EU level action.

3. PROBLEM DEFINITION

The requirements of the Accounting Directives apply to all limited liability companies without regard to other factors (e.g. size, financing or type of activities). Mostly small companies are subject to the same rules as larger companies. In many situations certain information must be processed only to satisfy legal obligations without real business needs. This corresponds to the definition of administrative burden. Two elements of this administrative burden can be further analysed:

- Administrative cost that is not related to the size of the company and is therefore disproportional for the smallest enterprises as compared to the larger enterprises

- Misalignment between requirements of the directives and the needs of the micro entities and the users of their financial statements

3.1. Disproportional administrative (compliance) cost as economic burden

Start-up businesses and small enterprises with limited resources are sensitive to excessive administrative obligations as they divert resources from the core business activities.

The substantial part of the administrative cost is fixed and micro entities sacrifice relatively much more resources to comply with a regulatory duty than bigger companies. Furthermore, micro entities' statutory financial statements have generally little value for its stakeholders.

3.2. Misalignment between requirements of the Accounting Directives and the needs of micro entities and users of their financial statements

Usually, very small companies are owner managed and statutory financial statements do not have significant relevance for their reviewing the company's performance. Moreover, investors in micro entities are often limited in number, often directly involved in running the company and with direct access/insight into company accounts. The source of financing is not the stock market but own resources, credits from banks or other financial institutions. The main users of the financial information (banks and tax authorities) have the possibility to demand information above and beyond the statutory reporting requirements. For the other stakeholders, the information needs are usually not covered by statutory financial information. This is because their relationships with small companies are often based on mutual trust rather than on (access to) financial information and because the current complexity of accounting statements makes them often useless / incomprehensible for many of the stakeholders.

3.3. How large is the problem?

Approximately 7.2 million EU companies are subject to reporting rules within the scope of the Accounting Directives. Some 5.4 million (around 75% of them) are micro entities.

A study prepared by Ramboll Management concluded that the average cost per company to comply with the requirements of the directives is €1558. Out of this amount, the administrative burden (i.e. collecting and processing information only to satisfy legal obligation without real business need) is €1169.

The above gives an approximation that the aggregate administrative burden on the EU level would be around €6.3 billion.

4. OBJECTIVES

In order to enhance the competitiveness of the micro-entities and release their growth potential, the administrative burdens should be reduced to the minimum. The objectives are:

- Reduction of the administrative burden of businesses in the EU, especially for SMEs and micro-entities, while safeguarding adequate protection and information to stakeholders.

- Enable alignment of the micro-entities' reporting requirements with the real needs of users and preparers.

5. POLICY OPTIONS AND THEIR EXPECTED IMPACT

5.1. Description of policy options

The Commission Services envisage following possible policy options:

Option 0. No change to the Directives

Option 1. Encourage a full use of existing options in the Accounting Directives

Option 2. Obligatory exemption of micro entities from the scope of the Directives

Option 3. Member State option to exempt micro entities from the scope of the Directives

Option 4. Introduction of a simplified mandatory accounting regime for micro entities

Option 5. Amendments to the Accounting Directive without introducing the micro category.

5.2. Option 0. No change to the Directives

In the baseline scenario, no action is taken and all 5.4 million micro companies will continue following the accounting rules of the directives and spending yearly around €6bn to comply with information obligations.

5.3. Option 1. Encourage a full use of existing options in the Accounting Directives

In case no legislative changes are made, the Commission can still call on Member States to utilise all the simplification options available in the Directives.

The estimate of the potential saving of the full use of existing thresholds and exemptions amount up to €1.8bn for the micro segment. However this amount is unlikely to be attained. The current Directive builds on general requirements with Member States possibility to exempt only from some of those requirements on a piecemeal basis. There is no possibility to make more general exemptions, which hampers the usability of these options, and thus has made them generally less appealing to Member States.

Furthermore, this option would not facilitate burden reduction in those Member States that are already using the options. Neither would it address the issue of discrepancy between the Accounting Directives to the user needs of smallest companies and the administrative burden resulting from this.

5.4. Option 2. Obligatory Exemption of Micro entities from the scope of the Directives

Obligatory exemption of micro entities would eliminate all EU level accounting requirements for this group – a case of maximum harmonization. The impact of this option is the same as the maximum impact of option 3, as discussed in the next section.

However, due to differences in accounting cultures and reporting traditions across EU, it is very unlikely that such a proposal would be politically acceptable for some EU Member States.

5.5. Option 3. Member State option to exempt micro entities from the scope of the Directives

Member States would have the possibility to determine the most relevant rules that micro entities should be required to comply with and, for example, integrate various reporting requirements into one.

Exempting micro entities from the scope of the Accounting Directive is expected to have the following impacts:

Reduction of administrative burden. In the maximum scenario where all Member States exempt micro companies and do not impose additional requirements the potential savings stemming from the proposal is estimated at €6.3bn (with range of €5.9bn to €6.9bn). It is, however, likely that many Member States after exempting micro entities from the Fourth Directive's obligations would impose other accounting requirements, e.g. to align tax and financial reporting. Such alternative requirements are likely to decrease the burden reduction for companies. However, at this point of time it is not possible to quantify the potential effect on EU level.

More relevant and understandable information to main users, including tax authorities and creditors, and management. The accounts could be made more relevant to the needs of stakeholders and management of micro businesses, taking into account the understandability criterion.

No significant negative impact on the information to the external stakeholders and creditors protection. The main users of accounts of micro entities are banks and tax authorities. Banks are generally no interested in sophisticated accounting information provided under directives' requirements. In their responses to the Commission Consultation of 2007, both banks and industry were generally in favour of exempting the micro entities from the requirements of the Accounting Directives.

Impact on the single market and level playing field. Impact on single market is expected to be insignificant as the financial reporting needs of micro entities are rather basic and the statutory accounts not a generally important source of information. Furthermore, only a low number of micro entities are involved in cross border activities.

Some negative impact on collection of statistical data in some Member States possibly requiring change in methodology of collection of statistical data.

No negative impact on collection of information for taxation. The tax authorities have the power to demand information according to their reporting requirements and to carry out verifications (audits) of the financial information.

Reduction of activities of accounting profession in preparation and audit of statutory accounts. This is expected to be partly substituted by use of professional accountants to other more added value purposes.

Social aspects. Some reduction of public information available to employees of the micro-entities. However, due to direct contact that employees usually have with the management and owner(s) of micro entities, the published financial statements have a lesser role in serving the information needs. Situation is similar to unlimited liability companies of the same size.

Environmental aspects. Minor positive impact due to reduction of reporting and filing activities.

Information to general public. Some reduction of public information available to external parties. However this interest is generally very low.

5.6. Option 4. Introduction of a simplified accounting regime for micro entities

One option is to include a micro-tailored accounting regime into the Accounting Directives. In contrast to the "exemption option" such a new regime would require a longer preparatory and implementing period. Therefore, it is not suitable to achieve quick burden reduction at the given timetable.

5.7. Option 5. Amendments to the current Directive without introducing the micro category.

It is possible to create some quick fixes to the Accounting Directives. These could produce limited burden savings in a short time span. However, they do not address the main concern of discrepancy between accounting directives and the user needs.

More substantial amendments would require a longer preparation time and are, therefore, not suitable to achieve quick burden reduction at the given timetable.

6. COMPARISON OF OPTIONS AND JUSTIFICATION FOR THE COMMISSION'S PROPOSAL

The option that provides the biggest burden reduction is the option to exempt micro entities. This option can also be implemented within shortest timeframe. The Commission considers that this option is therefore the most appropriate alternative in order to significantly reduce the administrative burden of the small business and align the reporting requirements with the needs of the users and preparers.

7. MONITORING AND EVALUATION

This proposal is closely linked to the general modernisation and simplification of the Fourth and Seventh Accounting Directives. Due to the close connection between these measures the monitoring and evaluation will be carried out together. A detailed monitoring plan will be part of the overall monitoring strategy in relation with the general revision of the Accounting Directives.

The evaluation of effects and functioning of the exemption for micro entities will include an assessment as regards the key objectives of better alignment of the accounting rules with the needs of the users and preparers of the financial reports and overall reduction of administrative burden. Furthermore, consideration will be given to the quality and accessibility of relevant financial information to stakeholders.