

# CURRENT TRENDS OF FINANCIAL REPORTING IN THE EUROPEAN UNION

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**Abstract:**

*The desire and the need to increase comparability between Member States in terms of accounting information contained in the financial statements resulted in an attempt to establish certain accounting standards that are valid in all EU Member States. These standards are willing to meet the needs of all types of entities regardless of their size and whether or not they are traded on financial markets and prepare consolidated financial statements.*

**Key words:** *accounting information, financial reporting, standardization, comparability, modernization*

**JEL classification:** *M41*

## 1. Financial reporting in the European Union influenced by globalisation

Nowadays, the globalisation phenomenon represents a debated concept, in the academic environment as well as the political one. Bob Milward defines the globalisation concept as representing the "movement of assets, services, capital and labour around the world in a coordinated and institutionalised interconnection, where the global connections are set for the assurance of efficiency in the use of the limited resources of the world" (Milward, B, 2003).

Globalisation has as a result the standardisation and uniformity phenomenon of different accounting systems, which makes the financial statements of entities around the world easier to understand by the users in the countries belonging to different cultures.

We notice that the European Commission has had its own normalisation program ever since 1965 regarding accounting regulation. Only in November 1995, The European Commission announced that it wanted the International Accounting Standard Committee (IASC) to continue its interest in the field of harmonisation, recommending the member states to align to the consolidation rules of the financial statements according to the IFRS. This fact represented a change from the initial plan of the Commission to develop a program for drawing up the European Standards. Thus, the European Union stopped the evolution, in parallel, of another set of national and international accounting standards and helped achieve the internationalisation of the financial statements.

The development of the European companies and their ambition to succeed on the financial markets outside the European Union, corroborated with the rejection of the financial markets from the United States of America of the financial statements that were not drawn up according to the American references, brought the European Union even closer to the IFRS.

Therefore, in its intention to create a unique European financial market, the European Commission announced in June 2000 that it wanted to ask all the companies quoted on the territory of the European Union to use the International financial Reporting Standards, starting with 2005. In June 2000, the European Council of

Ministries, which represented the supreme authority in taking decisions in the European Union, approved the IFRS regulation.

Consequently, starting with 2000, the closeness to IAS/IFRS was achieved by two different, but interconnected at the same time, parallel ways as follows:

- the closeness to the International Accounting Systems, by which the quoted companies should draw up the consolidated financial statements according to the International Financial Reporting Standards, leaving at the discretion of the member states the manner in which these would impose or allow the application of the IFRS in the case of the other entities;
- the closeness to the Accounting Directives, for those entities that did not draw up the financial statements according to the International Accounting Standards. However, because the evolution of accountancy in the European Union was desired to unfold in the same direction as the IFRS, the Directives had to be updated in order to reflect the changes of the IFRS. The directive referring to the fair value is an example in this matter. Thus, the national accounting standards used for the submission of the financial statements of entities were allowed to deviate to higher or a lower extent from the IFRS, which were used more for the drawing up and the submission of the financial statements of quoted companies. This vision belonged to some member states that considered the fact that the financial statements of entities, which were used more for setting the fiscal debts and the distributable profit, had to be drawn up according to the national accounting standards, this leading to the preservation and even the continuance of the evolution of these standards.

Nevertheless, the quoted companies represent a small percentage of the total number of active companies in the world economy. The European Union would like that the old European accounting directives answer better to the requirements that these companies should offer financial statements that should contain clear information for the comparison between the various European countries.

The European Union found itself in the situation to choose between adopting the International Reporting Standards for Small and Medium Sized Entities and to supplement and update the already existing accounting directives.

## **2. The modernisation of the European Accounting Directives or the adoption of the International Financial Reporting Standards?**

Starting from the fact that only 45,000 listed companies are registered together in 52 of the largest stock exchanges around the world and taking into account that there are almost 25 million entities in the private sector in Europe, there are almost 20 million entities in the private sector in the United States of America, and 99% of the companies have less than a hundred employees, the IFRS Foundation drew up simplified IFRS for Small and Medium Sized Entities in July 2009.

This attention paid to the SMEs results from the fact that this type of entities has the ability and the capacity to promptly react to the changes from the current markets, being at the same time competitive and adapting rapidly to the changes that take place in the world economy.

In the European Union, the manner in which an entity is classified as a micro-entity, a small or medium entity depends on the balance sheet total, the net turnover and the average number of employees during the financial exercise. They had to suffer changes in order to keep up with the inflation over time.

Nowadays, according to the Directive 2006/46/EC of the European Parliament and of the Council from 14 June 2006 the size criteria are presented as follows:

*The size criteria for the small and medium entities according to the Directive 2006/46/EC of the European Parliament and of the Council*

	Micro	Small	Medium
Balance sheet total	≤ 500,000 €	≤ 4,400,000 €	≤ 17,500,000 €
Net turnover	≤ 1,000,000 €	≤ 8,800,000 €	≤ 35,000,000 €
Average number of employees during the financial exercise	≤ 10	≤ 50	≤ 250

This version of the IFRS is intended to be a simplified one, in order to answer to the requirements for a better presentation and information of their users. These simplifications may be synthesised as follows:

- some aspects from the IFRS are eliminated if these are considered as irrelevant for the private entities;
- if the IFRS present options, this standard presents only one simpler option;
- reduced presentation of information;
- simplifications regarding the manner of acknowledgement and evolution;
- simplified elaboration.

Starting from the importance of the small and medium sized entities, as well as from their role in the European economy, the European Union initiated in November 2009 a consultation regarding the international financial reporting for the small and medium sized entities. The objective of this consultation was to gather information on the opinion of shareholders within the European Union about the recently published International Financial Reporting Standards for the Small and Medium Sized Entities. The participants to this consultation were the users of the financial statements, the public authorities, the national regulatory bodies, accountants and auditors.

To the question if they considered that the adoption of IFRS for small and medium sized entities should be stipulated in the general accounting frame of the European Union, 19 member states answered affirmatively (Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Greece, Spain, Hungary, Ireland, Lithuania, Luxembourg, Malta, Holland, Poland, Portugal, Romania, Sweden, Slovenia, Great Britain), while a number of 6 member states answered negatively (Austria, Belgium, Germany, France, Italy, Slovakia).

To the question if the respondents of the study felt the need for some European Directives, based on rules, 7 of the member states answered affirmatively, while 14 member states answered negatively.

The ones that answered affirmatively (Austria, Bulgaria, Czech Republic, Germany, Spain, Luxembourg and Slovenia) considered the supporters of the approach based on rules, wanted, in fact, the maintenance of the European Directives at the basis of the European harmonisation, especially regarding the financial reporting for the entities considered small. These emphasised the need for modernisation and simplification, criticising at the same time the lack of legitimacy of the international standardisation body, IASB. Others were in favour of some Directives based on principles, which could offer a general frame and the decision on the detailed requirements should be left at the discretion of the member states.

Therefore, this study reveals that for the member states to adopt the IFRS for small and medium sized entities, as a national standard, several fundamental principles

should be introduced in the Directives, as well as definitions, terminology and definitions used in the IFRS. The inclusion of the cash flow statement was also wanted, as well as guidance regarding the leasing and the events after the balance sheet date.

In addition, during this period (November 2009), the European Commission asked EFRAG to offer details on the incompatibilities existing between these IFRS for the SMEs and the Accounting Directives of the European Union.

As a result, EFRAG discovered only six differences, such as:

- the prohibition of presenting or describing an asset or an expenditure as extraordinary;
- the fair evaluation of a financial debt;
- the amortisation of the commercial fund in 10 years if the life cycle is not known;
- the receivable for unpaid shares is compensated in the own capitals;
- the resuming of an impairment of the commercial fund is not allowed;
- the optional return to the IAS 39 could generate differences.

In the period 26.03.2010 – 03.04.2010, the European Commission had a consultation regarding the need to revise the European accounting directives, on a number of 323 companies.

The proposed changes were:

- the simplification of the balance sheet format and of the profit and loss account;
- the introduction of the cash flow statement for the medium sized entities - 82% of these entities already drawing up this type of statement;
- the elimination of the requirements for certain entities to offer information on guarantees, engagements and other similar activities. The banks were in favour of the maintenance of these presentations. Even if they were not presented in the financial statements, the entities would be anyway bound to offer this information.
- the elimination of the requirements for certain entities to offer information on the extraordinary revenues;
- the relaxation of the reporting requirements on the postponed tax;
- the simplification of the evaluation rules and the adoption of an evaluation system based on cost with the option for fair value, and the reduction of the requirements on presenting the asset movement;
- the inclusion of certain presentation requirements referring to the transactions between the affiliated parties, as well as the nature and the purpose of activities which are not reflected in the balance sheet.

Regarding the possible introduction of IFRS for SMEs, we notice that only 38% of the respondents knew details about this issue. A percentage of 27% of the medium sized entities and 35% of the small entities from the group that knew about the issue of the IFRS for SMEs answered that they would provide this information rapidly. Moreover, a number of 123 entities was in favour of the adoption of IFRS for SMEs regarding the cost-benefit ratio. Others considered that this adoption would imply costs and additional analyses, the personal training of the staff, these justifying their opinion by saying that there were other ways of harmonisation.

The interviewed banks considered that the proposal for change of the current format was not useful and would cause numerous problems in the analysis of the financial statements. These claimed that the current directives had functioned very well for 30 years, and they should be supplemented or updated, but not simplified. From this point of view, the accountants were the supporters of these changes.

Regarding the cost and the economy achieved, the study reveals that the simplification of the balance sheet format would reduce 15% of the costs for the micro-entities, while the requirement of presenting the cash flow statement would increase the costs with 5% for the small entities.

Regarding the introduction of the IFRS for the SMEs, the study reveals the fact that it would lead to the increase of the costs with 13% for the micro-entities, with 4% for the small entities and with 6% for the medium ones.

On 25 October 2011, the European Commission proposed a Directive in order to replace and modernise the current Accounting Directives. This proposal simplifies the requirements for the small enterprises and wants to improve the clarity and the comparability of the financial statement of entities within the European Union.

The size criteria according to this new directive are presented as follows:

*Size criteria for the small, medium and large entities according to the proposal of changing the European Accounting Directives.*

	<b>Small</b>	<b>Medium</b>	<b>Large</b>
<b>Balance sheet total</b>	≤ 5,000,000 €	≤ 20,000,000 €	> 20,000,000 €
<b>Net turnover</b>	≤ 10,000,000 €	≤ 40,000,000 €	> 40,000,000 €
<b>Average number of employees during the financial exercise</b>	≤ 50	≤ 250	> 250

This process of modernisation aimed at the following primary objectives:

- the reduction of the administrative task, especially in the case of the small entities;
- a better clarity and comparability of the financial statement, especially for the categories of companies with cross-border activities;
- the protection of the international fundamental needs of the users;
- the increase of transparency regarding the payments performed in the benefit of the governments by the extractive industry and the sector of primary forest exploitation.

Regarding the small entities, representing 21% of the total number of entities, the proposal was that the information that must be provided in the explanatory notes should be limited to:

- the accounting policies;
- guarantees, engagements, assets and contingent debts and elements that are not acknowledged in the balance sheet;
- events that occur after the balance sheet date and that are not acknowledged in the balance sheet;
- long term debts and guaranteed debts;
- transactions with the affiliated parties.

We notice that the reporting of elements from the third and fifth points shall have as result new obligations for the small entities, because of the fact that the majority of the member states do not currently predict these requirements.

In addition, the harmonisation of the thresholds is proposed so that the small entities from the European Union should benefit from this reduction of the administrative task. Another change is the statutory audit that shall not be compulsory for the small entities, and the small groups shall be exempt from drawing up consolidated financial statements.

Regarding the medium and large entities, representing 4% of the total number of companies, the increase of comparability and clarity of the financial statements is aimed at in order to reduce the number of options, if they have a negative impact on the comparability of the financial statements. Thus, a series of general principles shall become compulsory, as for instance the principle of "significance threshold" and the principle of "substance over form". Regarding the IFRS for the SMEs, their mandatory adoption is not stipulated in the directive draft. The existing differences between them regarding the unpaid subscribed share capital and the amortisation periods for the commercial fund whose length of use cannot be estimated in a viable manner, makes the integral and explicit adoption of the IFRS currently impossible.

### 3. Conclusions

The use of different financial reporting standards has as purpose different results, which makes the interpretation of the data, the calculation of the economic and financial indicators and their presentation to be different according to the standard used.

We may state that the appearance of the IFRS for the SMEs has determined the European Union to take important steps in the simplification and the reduction of the administrative pressure and of the costs for the small and medium sized entities, by simplifying and at the same time updating the European Accounting Directives. The increase of comparability between the member states regarding the accounting information presented in the financial statements is also a desired objective.

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