PRESENT AND FUTURE OF NATIONAL ACCOUNTING REGULATIONS COMPLIANT WITH EUROPEAN DIRECTIVES

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Abstract:

Financial statements are the basic form to submit accounting information and they envisage the provision of information on an enterprise's financial status, performance and cash flow. The quality of financial reporting arises from accounting norms that impose a joint terminology ensuring accounting information's comparability, communication and understanding.

In the European Union, the standards adopted by the Council of European Communities aim at harmonizing accounting systems, preparing and submitting annual financial statements. To apply them, member states must first incorporate them into their own legislations resorting over time to various implementation solutions, which involves certain difficulties due to economic, social and political peculiarities.

In this respect, the European Parliament has adopted Directive 2013/34/EU regarding annual financial statements, consolidated financial statements and associated reports of various types of enterprises. The present paper envisages a comparative study of old directives (Fourth Directive and Seventh Directive) and the new Directive.

Keywords: *financial statements, microenterprises, public interest entities, fair value.*

JEL Classification: M41

1. Introduction

Directive 2013/34/EU of the European Parliament and of the Council dated 26 June 2013 regarding annual financial statements, annual consolidated financial statements and related reports of certain types of enterprises was published in Official Journal of the European Union no.182/29 June 2013. The new Directive repeals the Fourth and the Seventh Directives. Reviewing the current accounting directives has been imposed since they have been used in Europe for over 25 years, during which the business environment and accounting practices have changed and evolved.

Standard setters in European Union (EU) member states are required to bring into force its provisions by 20 July 2015. In addition, member states:

- inform the European Commission on the law and administrative documents issued to comply with the published Directive;
- transmit "compliance tables" between the provisions of the published Directive and national acts in order to ensure compliance with the new provisions.

2. Novelties of Directive 2013/34/EU

European Union member states have resorted over time to different implementation solutions related to the Fourth and the Seventh Directives. Given the important role played by small and medium enterprises, this Directive is based on the principle "think small first" both in the preparation and in the development of regulations on financial reporting

The main objectives of the Directive aim at:

- *reducing administrative costs* especially for small and medium enterprises with potential benefits to the business environment, and creating jobs. The Directive aims at developing regulations to ensure at the same time that the administrative tasks caused by their application are commensurate with the benefits they bring.

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- *improving the comparability of annual financial statements* at EU level in order to encourage cross-border investment by increasing the relevance and understandability of financial reporting requirements, responding to the information needs of different user categories of annual financial statements.
- *increasing the transparency of payments to governments* made by the entities operating in the mining industry or the exploitation sector of primary forests.

The Directive is developed in nine chapters envisaging: scope, definitions and company categories, general provisions and principles, balance sheet, and profit and loss account, notes to financial statements, consolidated financial statements, disclosure requirements, audit issues, provisions regarding their exemptions and restrictions, reporting payments to governments.

2.1 Reducing Administrative Costs Related to Financial Reporting

Directives are recommendations and relate in particular to annual financial statement models, assessment bases, accounting principles, financial reporting requirements.

Financial reporting involves:

- costs related to production, printing and publishing of financial information;
- costs related to auditing;
- potential costs generated by disclosing information to a competitor;
- costs of compliance with legal requirements.

Many of these costs are fixed or do not proportionally vary with a size, being more significant to microenterprises, and small and medium enterprises.

Businesses or groups are classified into small, medium and large, depending on size criteria referring to total assets, the net turnover and to the average number of employees during a financial year. Size criteria have been accepted by member states with slightly different values. Thus, an enterprise regarded as large in Romania and which submits audited financial statements can be classified as a medium-sized enterprise in another member state, without any obligation to submit audited financial statements. For this purpose, standardizing the existing criteria applicable to European entities is intended to determine financial reporting obligations.

Below there are the differences between the existing criteria laid down in national regulations and those provided in the new Directive.

National regulations by OMFP 3055/2009 classify enterprises into:

- Entities which in the end of a financial year do not exceed two of the three size criteria:
  - Total assets 3,650,000 Euro;
  - Net turnover 7,300,000 Euro;
  - Average number of employees during a financial year 50.

These enterprises submit only short versions of balance sheet, profit and loss account and notes to simplified financial statements.

- Entities which in the end of a financial year exceed two of the three size criteria:
  - Total assets 3,650,000 Euro;
  - Net turnover 7,300,000 Euro;
  - Average number of employees during a financial year 50.

The entities that exceed two of the three size criteria submit a full set of annual financial statements:

National Regulations by OMPF 2239/2011 state that the people who in the previous financial year had a net turnover in RON less than its equivalent in 35,000 Euro and total assets in RON less than their equivalent in 35,000 Euro can choose the simplified accounting system.

Regulations on the classification of enterprises laid down in Directive 2013/34/EU are shown in the following table (Table no.1).

Table no. 1. Quantitative Criteria to Classify Enterprises According to the New European Directive

	Microenterprises	Small enterprises	Medium enterprises	Large enterprises
***New European Directive*:**	Microenterprises are companies that, on the balance sheet date, do not exceed at least two of the following three criteria: - total balance sheet: 350,000 Euro; - net turnover: 700,000 Euro; - average number of employees during a financial year: 10	Small enterprises are companies that, on the balance sheet date, do not exceed at least two of the following three criteria: - total balance sheet: 4,000,000 Euro; - net turnover: 8,000,000 Euro; - average number of employees during a financial year: 50.	Medium enterprises are companies that are not micro- or small enterprises and that, on the balance sheet date, do not exceed at least two of the following three criteria: - total balance sheet: 20,000,000 Euro; - net turnover: 40,000,000 Euro; - average number of employees during a financial year: 250.	Large enterprises are companies that, on the balance sheet date, exceed at least two of the following three criteria: - total balance sheet: 20,000,000 euro; - net turnover: 40,000,000 Euro; - average number of employees during a financial year: 250.

• Optionally, there is the category of ***microenterprises*** as such companies have limited resources and one can avoid burdensome requirements for them.

• There is also the category of ***public interest entities***. This category includes listed entities, credit institutions, insurance companies and "entities designated by member states as public interest entities, e.g. companies having significant relevance to the public by the nature of their operations, their size or number of employees". For the purposes of the Directive, these entities are regarded as large enterprises, regardless of the size criteria for enterprise classification.

The above shows the possibility of significantly reducing the number of entities in Romania that will be required to submit a full range of statutory audited financial statements. A decision to be made aims at either maintaining single accounting regulations under the new Directive containing simplification elements for microenterprises and SME's or creating differentiated regulations for microenterprises, small and medium enterprises and for large enterprises and groups. Professional accountants think as most appropriate to have a solution to develop a separate regulation for SME's and microenterprises.

2.2 Improving the Comparability of Annual Financial Statements

Annual financial statements are intended to provide information to various external users so another objective is to increase the comparability of financial statements of entities performing international operations and having a larger number of external users, to protect investor interests by retaining the essential information for them.

The new Directive does not specify what full range of financial statements should be included, stating they constitute a whole and to all enterprises, it comprises at least a balance sheet, a profit and loss account, and notes to financial statements. Member states may provide that enterprises, except the small ones, must incorporate other statements, too in their annual financial statements. Additionally, there is an exemption that member states can provide to SME's after the publication of the directors' reports provided the notes should include information on the purchase of own shares.

In this respect, there are the *formats of annual financial statements, the general principles of financial reporting, assessment rules*.

• Regarding the *format of annual financial statements,* two formats of balance sheets and profit and loss accounts are provided. Member states may require one or both structures in either situation.

The new Directive has two balance sheet formats. The former format is horizontal and is based on the equation ASSETS = OWNERSHIP EQUITY + DEBTS. The latter format is vertical and is based on the equation ASSETS - DEBTS = OWNERSHIP EQUITY. There are no significant differences between the balance sheet patterns referred to in the old directives and that in the new Directive. Microenterprises are exempted from the submission of items "Accrued expenses and accrued income" and "Deferred income and debt incurred".

The old Fourth Directive provided two models of profit and loss account (the model of operating expense allocation by nature, and the model of allocation by function) in two (horizontal and vertical) formats. The new Directive keeps only the format list for both the expense allocation model by nature, and the expense allocation model by function. A significant difference is that the new Directive does not provide any separate submission of extraordinary items. This solution is consistent with the one adopted by the IASB in revised IAS 1.

Depending on size criteria, entities have different reporting obligations (Table No. 2).

Table no. 2. Reporting Obligations of Enterprises and Enterprise Groups under the New European Directive

	Small enterprises	**Medium enterprises**	**Large enterprises**
***New European Directive*:**	member states may allow the submission of: - short-version balance sheet; - short-version profit and loss account; - notes to financial statements; - directors' report.	member states may allow the submission of: - short-version balance sheet; - short-version profit and loss account; - notes to financial statements; - directors' report.	- balance sheet; - profit and loss account;; - statement of cash flows; - statement of changes in ownership equity; - explanatory notes; - directors' report - audit report.
	Small groups	**Medium groups**	**Large groups**
	- small groups are exempt from the obligation of preparing consolidated financial statements and directors' consolidated reports, unless one of the affiliated companies is a public interest entity.	- member states may exempt medium groups from the obligation of preparing consolidated financial statements and directors' consolidated reports, unless one of the affiliated companies is a public interest entity.	- full set of consolidated financial statements; - directors' report; - audit report.

Member states may provide simplifications such as:

- small enterprises can prepare short-version balance sheets only submitting certain information;
- small and medium enterprises can prepare short-version profit and loss accounts, combining certain elements into one;

• Regarding the **information submission requirements in the explanatory notes to financial statements**, they meet the principle: "think small first", as firstly there are requirements common to all enterprises regardless of their sizes, and distinctly, gradually, additional requirements applied to different categories of enterprises (medium, large, public interest entities).

The information required to all categories of enterprises refers to:

- accounting policies adopted;
- information on reassessment;
- information on fair value assessment;
- information on financial commitments;
- amount of advance payments and credits granted to administration, management and supervision members;
- amount and nature of income and expense items that have exceptional size or incidence;
- amounts due by an enterprise, amounts that become enforceable after more than five years;
- average number of employees during a financial year.

• Regarding ***general financial reporting principles***, the national regulations by OMFP 3055/2009, as it is now, prescribes the ten principles retained in the new Direction. No changes are expected in terms of the accounting principles applicable to financial reporting.

To ensure that the general principles of financial reporting are applied in a manner consistent with the specifications of the Directive, certain accounting policies set out by the Order should be reconsidered, namely:

➢ Member states may exempt enterprises from applying the principle of substance over form. It is believed, however, that using this option would affect the quality of reported information and it would be inconsistent with a true and fair view.

➢ ***Great importance is given to the principle of prudence***. The Directive provides that member states may allow the recognition of expected debts and potential losses.

➢ ***The principle of intangibility*** requests that an opening balance sheet should correspond with a closing balance sheet. Nevertheless, member states may require the adjustment of figures for the previous financial year if the amounts shown in financial statements are not comparable. If values are not comparable or if they are adjusted, this must be stated in the notes to financial statements, accompanied by explanations.

• Regarding ***assessment***, the new Directive states that the items recognized in annual financial statements should be assessed based on the historical cost principle to ensure that the information contained in financial statements is valid. However, member states should be authorized to allow or to impose on enterprises the re-assessment of fixed assets in order to provide more relevant information to financial statement users. For the financial information across the Union to be comparable, it is necessary for member states to allow the introduction of a fair value accounting system in the assessment of categories other than financial instruments. Fair value is determined by reference to market price. If market prices are not reliably determinable, fair value is calculated as the updated sum of future cash flows (Grigorescu, 2008, p. 182). Fair value assessment should be allowed to all enterprises or enterprise groups other than microenterprises using the exemptions provided for in this Directive, both for annual financial statements and for consolidated financial statements.

2.3 Increasing Transparency of Payments to Governments

To ensure greater transparency of payments made to governments, large enterprises and public interest entities operating in the extractive industry or in the exploitation sector of primary forests should submit significant payments made to governments in the countries where they operate, in a separate annual report.

The report includes:

- total amount of payments made to each government;
- total amount per type of payment made to each government;
- whether payments have been assigned to a specific project.

For the purpose of the Directive, a “project” means operational activities which are regulated by a single contract, license, location, concession or other similar legal agreements which form the basis of a payment obligation to a government. It is not necessary for a payment, whether it is a single payment or a series of related payments, to be considered in relation to whether it is less than 100,000 Euro during a financial year.

3. Conclusions

In this article, the authors have tried to show significant elements of this new Directive compared to national accounting regulations:

The new Directive does not entail fundamental changes in financial reporting models. The main contribution of the Directive is to uniform size criteria according to which entities and groups are classified as small, medium and large, simplification requirements for certain categories of entities (microenterprises and SME’s) and additional information requirements imposed on others (entities and large groups).

Accounting standard setters in the EU member states ***have an important role as to what extent they will integrate*** in local regulations or standards the accounting policies inspired by international financial reporting standards (IFRS), as this new Directive in its current form is not closer to the IFRS referential.

It is appreciated that OMFP 3055/2009 in its current form is a consistent product that can be rendered relatively easily compliant with the requirements of the new Directive. What must be decided is whether to issue variable regulations according to the categories of entities concerned or whether the legislation will be unique and will include simplifications to microenterprises, SME’s and small groups. In the authors’ opinion, the best solution would be the development of three different regulations: accounting regulations applicable to microenterprises; accounting regulations to SME’s and small groups; accounting regulations applicable to large enterprises and medium and large groups.

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