COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION

ACCOUNTING HARMONISATION : A NEW STRATEGY VIS-A-VIS INTERNATIONAL HARMONISATION

1. Introduction and Summary

1.1 The Fourth and the Seventh Company Law Directives provide a harmonised basis for the preparation of the accounts of individual companies and groups of companies in the EU. They have been successful in bringing about a general raising of accounting standards, in improving the comparability of accounts and thus the conditions for cross-border business and in allowing the mutual recognition of accounts for the purposes of quotation on securities exchanges throughout the Union.

1.2 The Directives do not, however, provide answers to all the problems facing the preparers and users of accounts and accounting standard setters in the 1990s. Some issues are not addressed at all in the Directives. Others were settled when the Directives were originally negotiated by the inclusion of numerous options, or by formulas which are open to different interpretations. Accounts prepared in accordance with the Directives and the national laws which implement them do not meet the more demanding standards required elsewhere in the world, notably by the Securities Exchange Commission in the United States.

1.3 The result of this last problem is that large European companies seeking capital on the international capital markets, most often on the New York Stock Exchange, are obliged to prepare a second set of accounts for that purpose. This is burdensome and costly and constitutes a clear competitive disadvantage. Producing more than one set of accounts also causes confusion. Moreover, it involves companies in conforming with standards (US Generally Accepted Accounting Practices or GAAP) which are developed without any European input. As more and more Member States are implementing important privatisation programmes and as the capital needs of the companies concerned are increasing, the number of companies facing this problem is growing.

1.4 The approach proposed in the present communication consists of putting the Union's weight behind the international harmonisation process which is already well under way in the International Accounting Standards Committee (IASC). The objective of this process is to establish a set of standards which will be accepted in capital markets world-wide. The Union must at the same time preserve its own achievements in the direction of harmonisation, which are a fundamental part of internal market law. It therefore needs to take steps to ensure that existing international standards (IAS) are consistent with the Community's Directives and that IAS which remain to be formulated remain compatible with Community law.

1.5 There needs to be closer cooperation within the Union, through the improved functioning of the existing bodies at EU level which deal with accounting issues, to reach agreed positions on both international and internal accounting issues. This would strengthen the influence of the EU in the international harmonisation debate and help improve consistency of application of agreed standards in the Member States, especially for the consolidated accounts of groups of companies.

1.6 It is proposed to carry out this reform as far as possible without any change in the Accounting Directives.

2. Background

2.1 Company law harmonisation is based upon Article 54(3)(g) of the EC Treaty. The Fourth Council Directive ((78/660/EEC) of 25 July 1978 requires all limited liability companies to prepare annual accounts. In conformity with its legal base, the Fourth Directive does not aim to achieve a complete standardisation of accounting rules. Its objective is rather the comparability and equivalence of financial information. The Directive therefore contains a large number of options for Member States or for companies, which permit different accounting treatments. Comparability between different options is established through additional information in the notes which must accompany the balance sheet and the profit and loss account. Exemptions are allowed for small and medium-sized companies.

2.2 The Seventh Council Directive (83/349/EEC) of 13 June 1983 concerns consolidated accounts. It requires a parent company to prepare, in addition to its individual accounts, consolidated accounts and a consolidated annual report in which the financial situation of the group is shown as if it were a single entity.

2.3 These Directives were followed by two sectoral Directives, dealing with the financial information to be disclosed respectively by banks and other financial institutions (Council Directive 86/635/EEC of 8 December 1986) and by insurance companies (Council Directive 91/674/EEC of 19 December 1991). These Directives contain the derogations from the Fourth and Seventh Directives necessary to take account of the particular characteristics of the entities concerned.

2.4 Problems of application and interpretation of the Directives are discussed in the Contact Committee on the Accounting Directives which was set up under Article 52 of the Fourth Directive. This Committee is chaired by the Commission and usually meets twice a year. It is composed of experts from the responsible ministries of Member States.

2.5 The adoption and implementation of the Fourth and Seventh Directives, with their later amendments, were only achieved with difficulty and no further progress has been made at EU level in harmonising the basic rules on accounting and financial reporting. There is disagreement between Member States about the usefulness of the Directive as an instrument for accounting harmonisation: certain Member States would prefer a broader international harmonisation and/or harmonisation based on standards rather than law.

2.6 At a Conference which the Commission organised in 1990 on the future of harmonisation of accounting standards in the EU, a clear preference was expressed for not reducing the number of options in the Directives, for not adopting new legislation in the near future and for the need to take into account the harmonisation efforts at a broader international level.

2.7 Following that Conference, in order both to open the debate on accounting issues at European level and to influence the work of national accounting standard setting bodies, the Commission set up the Accounting Advisory Forum. National standard setters and European organisations of users and preparers of accounts work together in the Forum to find technical solutions for a number of problems not yet dealt with in the Accounting Directives. After a difficult start, the Forum has done excellent work, but in the absence of a clear mandate, the results of its work do not carry enough weight to exercise a real influence on accounting developments.

2.8 Also as a result of the Conference, the Commission decided to take up the invitation extended to it by the International Accounting Standards Committee (IASC) to become a member of its Consultative Group and to sit on the Board in an observer capacity. IASC is a private organisation which was set up in 1973 by the accounting profession. It has been working on the development of a comprehensive set of international accounting standards. These standards, although not legally binding, are used by several large and multinational companies throughout the world. They have also influenced the standard setting process in a number of countries. The International Organisation of Securities Commissions (IOSCO) has recently reached an agreement with IASC on a joint work programme, which aims to produce in the medium-term a core set of international accounting standards to be applied by companies seeking a multinational listing of their securities. The realisation of this objective would make it easier for European companies which apply International Accounting Standards (IAS) to have access to international capital markets and especially to the US capital market.

2.9 Work on accounting standards has also been carried out in various other international fora (UN, OECD etc). Most recently, the WTO's working party on Professional Services received a mandate to make recommendations designed to remove unnecessary barriers to trade in accountancy services and also to "concentrate in particular on the use of international standards", taking account of the work of international standard setting bodies.

3. The need for a new approach

3.1 The Fourth and Seventh Directives have allowed the preservation of the different accounting traditions which existed in Member States prior to their adoption, but have at the same time had a real positive impact. The quality of financial reporting has considerably improved in Member States. The free circulation of comparable financial information constitutes an important condition for the proper functioning of the Internal Market and helps foster competition.

3.2 There are nevertheless a number of problems which need to be addressed if the progress achieved so far is to be preserved and if the Union is to be in a position to deal with the important challenges which face it.

3.3 The most urgent problem is that concerning European companies with an international vocation. The accounts prepared by those companies in accordance with their national legislation, based on the Accounting Directives, are no longer acceptable for international capital market purposes. These companies are therefore obliged to prepare two sets of accounts, one set which is in conformity with the Accounting Directives and another set which is required by the international capital markets. This situation is not satisfactory. It is costly and the provision of different figures in different environments is confusing to investors and to the public at large. There is a risk that large companies will be increasingly drawn towards US GAAP. They and the Member States are looking to the Union for a solution that can be implemented rapidly.

3.4 Other problems relate to the Directives themselves. The Directives allow several options and do not address a number of accounting issues which have become increasingly relevant since they were adopted. This, together with the fact that some principles contained in the Directives are interpreted differently in different Member States, has had negative consequences for the comparability of accounts. Externally, the absence of a common position on accounting issues has prevented the EU from playing an effective role in international fora which discuss accounting issues. The fact that EU Member States have difficulty in coordinating their efforts and in identifying a common position is also disorienting for other European countries which increasingly look to the EU when they have to establish or to reorganise their national accounting systems.

3.5 Furthermore, a new approach is also needed because changes have taken place in Member States since the adoption of the Accounting Directives in terms of the process through which accounting standards are being adopted. Because of the need for accounting standards to follow economic developments, many Member States have established Accounting Standard Setting Bodies which further develop the accounting rules which are incorporated in the law. Work on accounting at European level needs to adapt to these changes, without of course dismantling the present Directive-based approach.

4. Possible solutions examined

4.1 The Commission has examined several possible approaches to dealing with the problems described above and has discussed them with the Member States, most recently at the meeting of the Contact Committee on 11/12 September.

4.2 Concerning the most urgent problem, namely that of large listed companies, one solution would be to exclude them from the scope of application of the Directives and thus free them to follow other rules. This would raise a number of questions as to the scope of the exclusion (all listed companies, certain listed companies, companies with important non-EU shareholdings, etc.) and as to the rules which the excluded companies would then be allowed to apply (international accounting standards, US standards or both). It would require a change in the Directives, which would take time. Finally, it would involve abandoning the homogeneous approach to accounting harmonisation which has served the Union well up to now.

4.3 Another solution would be to obtain an agreement with the United States on the mutual recognition of accounts. The Commission has attempted to initiate such discussions, but has found little interest on the American side. Accounts prepared by US companies under US GAAP are in fact already recognised in all Member States. This is not the case in the US for accounts prepared by European companies in accordance with the Accounting Directives. The Directives themselves do not provide a sufficiently detailed set of standards to meet US requirements.

4.4 Of the various international bodies working on accounting standards, for the time being only the IASC is producing results which have a clear prospect of recognition in the international capital markets within a timescale which corresponds to the urgency of the problem.

4.5 Another part solution, addressing the internal problems identified, would be an update of the Accounting Directives, to include technical solutions for the various accounting issues which have not yet been dealt with. It would however be difficult to agree on the issues which should be covered in such a revision. Some Member States might seek to renegotiate parts of the Directives they do not like. The preparation and negotiation of such an important revision of the Directives would take a long time and new issues would probably arise by the time the amendments have been finally adopted and implemented in Member States. Amendments to the Directives would be best confined to cases where it is necessary to provide legal certainty.

4.6 Another option which has been considered is the creation of a European Accounting Standard Setting Body. To set up such a body (which would require legislation) and to develop a comprehensive set of European accounting standards would take a great deal of time. Most Member States have expressed misgivings about creating an additional layer of standards, bearing in mind in particular the progress already made with IAS.

5. Proposed approach

5.1 In preparing its recommended approach to current accounting problems, the Commission has paid particular attention to respecting the principles of subsidiarity and proportionality, as now enshrined in the Maastricht Treaty. New legislation or amendments to existing legislation at the EU level should be avoided so far as possible. It is also desirable to avoid the creation of an additional layer of standards on top of those already existing or in preparation. A more flexible framework is needed which can respond rapidly to current and future developments. At the same time, the necessary degree of legal certainty must be preserved and respect for Community law ensured.

5.2 In order to deal with the urgent issue of European companies which are looking for listings on the international capital markets, the Commission proposes first to examine with Member States in the context of the Contact Committee, as a matter of priority, the conformity of existing International Accounting Standards (IAS) with the Accounting Directives. Establishing that these standards are in conformity with the Accounting Directives is an essential first step if Member States are to allow their large companies to prepare their accounts on this basis. (It is up to Member States to conduct a similar exercise with regard to their national law. Since national laws do not make use of all the options in the Directives, an IAS which is in conformity with the Directives may nevertheless infringe national law.)

5.3 If this examination reveals any inconsistencies between the Directives and IAS, these will need to be examined on a case by case basis. The Commission's preliminary view is that few if any difficulties will emerge. In case of conflict, a solution will have to be found. One solution would be to ask the IASC to change the relevant standard. Another solution would be to amend the Directives. The IASC's executive has indicated its willingness to re-examine any IAS which are found to be not in conformity with the Directives. If absolutely necessary, the Commission will propose changes in the Directives. If the Directives have to be changed to deal with a conflict between an IAS and a provision in a Directive, the Commission believes that serious consideration should be given to delegating powers to a committee so as to accelerate the procedure for amending the Accouting Directives. It can indeed not be excluded that other conflicts with IAS will arise in the future. It would be useful if the EU were then in a position to adapt its regulatory framework more quickly.

5.4 In order to ensure an appropriate European input into the continuing work of the IASC, the Contact Committee will examine and seek to establish an agreed position on future Exposure Drafts (or draft standards) published by the IASC. An agreed Union position on Exposure Drafts can thus be conveyed to the IASC. This will allow the Union progressively to gain a position of greater influence on the IASC's work, including the determination of its agenda, so that its output will increasingly reflect the EU viewpoint.

5.5 To provide a mechanism for reaching an agreed position on issues such as compatibility with IAS, it is proposed to give a bigger role to the Contact Committee. The Committee's capacity to work on technical matters will be strengthened by the establishment of subcommittees which will be able to draw on the necessary technical expertise. Work will be organised in a pragmatic way, in cooperation with the Member States, to minimise extra costs.

5.6 The work of the Contact Committee should focus on consolidated accounts . A more general approach including individual accounts would be more likely to run into controversy, since these are in many Member States directly related to reporting for tax purposes. A focus on companies preparing consolidated accounts is also justified because these companies are more directly affected by the problems described above.

5.7 For those companies which are not directly concerned with the pressure of international capital markets and which prepare consolidated accounts, it is intended to continue efforts to improve the comparability of accounts. The Contact Committee should step up its efforts to facilitate a harmonised approach by dealing with practical problems which arise in connection with the application of the Directives. Through discussion in the Contact Committee, the Commission will seek to ensure a better coordination of the activities carried out by the various bodies in Member States which deal with accounting standards. The Commission will decide how to make the best use of the advice given by the Committee, for example to include it in an interpretative communication or in a recommendation. The Commission will give adequate publicity to the work of the Contact Committee where necessary. It is expected that SME's which are looking for outside capital will ultimately benefit from improved financial reporting at the level of consolidated accounts.

5.8 It is clear that this flexible approach is only possible within the limits determined by the Accounting Directives. Respect for the Directives must be ensured and, to the extent that legal certainty might require this, the Commission will not hesitate to make proposals for the amendment of the Directives where necessary. Effective technical cooperation in the Contact Committee will make it possible to avoid legislation in most cases. It is therefore essential that all institutions which are dealing with accounting standard setting at national level should be involved in the work of the Contact Committee and that their representatives should have the necessary expertise to contribute to technical discussions.

5.9 The Accounting Advisory Forum will continue its role as a consultative body. It will ensure that users and preparers remain closely associated with the work of the EU in the accounting field. An appropriate coordination between the Forum and the Contact Committee could be ensured by inviting the members of the Contact Committee to participate in the meetings of the Forum and associating the expertise of the Forum with the technical work of the Contact Committee.

6. Conclusions

The Union needs to move promptly to offer the users and preparers of accounts a clear prospect that companies seeking listings on the US and other world markets will be able to remain within the EU accounting framework and that US GAAP, over which they and their governments can exercise no influence, is not the only option. It also needs to made clear that the Community is not abandoning the field of accounting harmonisation, but is rather strengthening its commitment and contribution to the international standard-setting process, which offers the most efficient and rapid solution for the problems of companies operating on a world-wide scale. These messages require the explicit support and agreement of the Member States, if they are to be effective.

FINANCIAL STATEMENT

1 TITLE OF OPERATION

"Accounting Harmonisation: a new strategy vis-à-vis International Harmonisation".

2 BUDGET HEADING INVOLVED

Part A : Human Resources (see paragraph 10)

A 130 : missions

A 1178 : technical assistance

A 1520 : national experts

A 2510 : meetings of committees

3 LEGAL BASIS

EC Treaty : Articles 54 (3)(g) and 3b).

White paper on Growth, Competitiveness and Employment (Chapter 2).

4 DESCRIPTION OF OPERATION

4.1 General objective

The general objectives of the new accounting strategy may be summarised as follows:

— To bridge the gap between the present financial reporting requirements in the EU and the needs of the international capital markets.

— To continue efforts to improve the comparability of accounts.

— To ensure an appropriate European input into the international harmonisation debate.

4.2 Period covered and arrangements for renewal

Although the new strategy is designed for the long-term, a first report on its effectiveness will be presented at the end of 1997. The strategy may then be adapted, having regard to the results contained in the report. This is why the present financial plan is limited to 1996 and 1997.

5 CLASSIFICATION OF EXPENDITURE OR REVENUE

5.1 Compulsory/Non-compulsory expenditure

Non compulsory expenditures.

5.2 Differentiated/Non-differentiated appropriations

Non differentiated appropriations.

5.3 Type of revenue involved

No revenues involved.

6 TYPE OF EXPENDITURE OR REVENUE

The expenditures involved are made up of the costs relating to the additional staff, the missions necessary, and the services provided by a specialised consultant, as indicated in point 10. The costs shown in the tables below only refer to the Commission's expenditure. It is assumed that Member States will support all other expenditures linked to this strategy and not included in this financial plan.

- 100% subsidy : NO
- Subsidy for joint financing with other sources in the public and/or private sector: NO
- Interest subsidy: NO
- Other: NONE
- Should the operation prove an economic success, is there provision for all or part of the Community contribution to be reimbursed? NO
- Will the proposed operation cause any change in the level of revenue? If so, what sort of change and what type of revenue is involved? NO

7 FINANCIAL IMPACT:

NO IMPACT ON PART B OF THE BUDGET

8 Fraud prevention measures

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

9 Elements of cost-effectiveness analysis

9.1 Specific and quantified objectives; target population

The actions will ensure:

— for European companies with an international vocation which are looking for a listing in non-EU capital markets, the possibility of presenting one set of financial statements. This will reduce their costs.

— for other companies, the improved comparability of consolidated accounts. This will foster competitiveness inside the EU and will ultimately also benefit SME'S which are looking for outside capital.

9.2 Grounds for the operation

The proposed new strategy is based on the principles of subsidiarity and proportionality and will establish enhanced cooperation between the Commission and the Member States and between the Member States themselves in the accounting sector. The approach proposed in the Communication has been selected after all possible alternatives have proven to be impractical.

The new accounting strategy will be based on common positions, obtained through an increased number of meetings of the Contact Committee on the Accounting Directives and its sub-committees. These common positions will have a multiplicatory effect as, when adopted by Member States, will be applied by limited liability companies based therein.

The above-mentioned meetings will be held in different Member States, who will support the related costs. As a consequence, the Commission will only have to provide for the missions of its officials participating in these meetings.

9.3 Monitoring and evaluation of the operation

An evaluation of the action will be made in 1997, based on a report prepared by the Commission on the work carried out during the period 1996-1997.

10 ADMINISTRATIVE EXPENDITURE (SECTION III, PART A OF THE BUDGET)

Actual mobilization of the necessary administrative resources will depend on the Commission's annual decision on the allocation of resources, taking into account the number of staff and additional amounts authorized by the budgetary authority. The allocation of supplementary resources is to be considered in the context of priorities to be decided by the Commission within the limits of the budgetary means available in the annual budget.

10.1 Effect on the number of posts

Type of post		Staff to be assigned to managing the operation		Source		Duration
		Permanent posts	Temporary posts	Existing resources in the DG or department concerned	Additional resources	
Officials or temporary staff	A		1		1	1997
	B					
	C					
Other resources			2	2		1996-1997
Total			3	2	1	

The implementation of the new strategy requires staff resources. Because of the specialised nature of the work, an A grade END is needed for the period 1996-1997. Technical assistance of a specialised consultant for two years (1996+1997) is also necessary. On the basis of the experience acquired in 1996, the resources needed for 1997 will have to be reassessed, possibly with the engagement of an A grade temporary post.

10.2 Overall financial impact of additional human resources

ECU

	Amounts (ECU)	Method of calculation
Officials		
Temporary staff (Titles A1, A2, A5)	100.000	1 'A' Temporary post for 1 year (1997)
Other resources		
Total	100.000	

The cost of the staff to be assigned to managing the operation through the use of existing resources in DG XV has been estimated as follows:

- Technical assistance (A 1178)	200.000 Ecus	(1996 - 1997)
- National Experts (A 1520)	70.000 Ecus	(1996 - 1997)
Total	270.000 Ecus	

10.3 Increase in other administrative expenditure as a result of the operation

ECU

Budget heading	Amounts (ECU)	Method of calculation
- Missions (A 130)	51.000	
- Meetings (A 2510)	24.000	2 meetings (1996+1997)
Total	75.000	

Mission costs include cost of transportation and daily allowance costs for two officials of grade A. 28 Missions of two days (and one night) each have been forecasted. Costs are calculated in constant Ecus (base 1995).

The cost of Meetings represents the cost of one additional meeting of the Contact Committee on the Accounting Directives per year. The Contact Committee at present holds two meetings per year, at an annual cost of 24.000 Ecus.

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