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Proposal for a fourth directive
ON THE ANNUAL ACCOUNTS
OF LIMITED LIABILITY COMPANIES

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COMMISSION
of the European Communities

**Proposal for a fourth Directive
on the basis of Article 54(3)(g) for
coordination of the safeguards required
from companies in the Member States
to protect the interests both of members
and of third parties, as regards the
presentation and content of the annual
accounts and report methods of valuation,
and publication of those documents**

(10 November 1971)

Brussels

THE COUNCIL OF THE EUROPEAN COMMUNITIES

Having regard to the Treaty establishing the European Economic Community, and in particular Article 54(3)(g) thereof;

Having regard to the proposal from the Commission;

Having regard to the Opinion of the European Parliament;

Having regard to the Opinion of the Economic and Social Committee;

Whereas coordination of the national provisions concerning the presentation and contents of the annual accounts and report, methods of valuation and publication of those documents in respect of the Société anonyme, the Aktiengesellschaft, the Società per azioni and the naamloze Vennootschap and in respect of the Société à responsabilité limitée, the Gesellschaft mit beschränkter Haftung, the Società a responsabilità limitata and the Vennootschap met beperkte aansprakelijkheid is of special importance for the protection of members and third parties;

Whereas simultaneous coordination is requisite in these fields for those forms of company because, on the one hand, the activities of those companies frequently extend beyond the frontiers of their national territory and, on the other hand, they offer no safeguards to third parties beyond the amount of their net assets; whereas moreover the necessity and urgency of such coordination have been recognised and confirmed in Article 2(1)(f) of Directive No. 68/151/EEC of 9 March 1968;

Whereas it is also necessary to establish in the Community equivalent legal requirements as regards the extent of the financial information that should be made available to the public by companies that are in competition with one another and have the same legal form;

Whereas the annual accounts must reflect as accurately as possible the company's assets and liabilities, financial position and results; whereas to this end a lay-out comprising items that in principle are obligatory must be prescribed for drawing up the balance sheet and profit and loss account; and whereas on the other hand the different methods permitted in the Member States for valuation of assets and liabilities must be coordinated to ensure that annual accounts present equivalent information;

Whereas the annual accounts of sociétés anonymes, Aktiengesellschaften, società per azioni and naamloze vennootschappen must be available in the fullest possible measure to shareholders and third parties; and whereas to that end it is essential that they be published in full in a national gazette;

Whereas so far as regards sociétés à responsabilité limitée, Gesellschaften mit beschränkter Haftung, società a responsabilità limitata and vennootschappen met beperkte aansprakelijkheid a distinction may be made between the

information to be given to the members and that to be given to third parties; whereas the members thereof should be given the same information as the shareholders in a société anonyme, Aktiengesellschaft, società per azioni and Naamloze Vennootschap; whereas for the information of third parties the same particulars should as a general rule be disclosed as in the case of these latter types of company by reason of the fact that the liability of the members is limited, but some relief can nevertheless be allowed in the case of the smaller companies;

HAS ADOPTED THIS DIRECTIVE:

Article 1

1.(a) The coordination measures prescribed by Articles 2 to 47 of this Directive apply to the laws, regulations and administrative provisions of the Member States relating to the following types of company:

- in Germany:
die Aktiengesellschaft, die Kommanditgesellschaft auf Aktien;
- in Belgium:
la société anonyme, de naamloze vennootschap; la société en commandite par actions, de commanditaire vennootschap op aandelen;
- in France:
la société anonyme, la société en commandite par actions;
- in Italy:
la società per azioni, la società in a accòmandita per azioni;
- in Luxembourg:
la société anonyme, la société en commandite par actions;
- in the Netherlands:
de naamloze vennootschap, de commanditaire vennootschap op aandelen

(b) The coordination measures prescribed by Articles 48 to 50 of this Directive apply to the laws, regulations and administrative provisions of the Member States relating to the following types of company:

- in Germany:
die Gesellschaft mit beschränkter Haftung;
- in Belgium:
la société de personnes à responsabilité limitée, de personenvennootschap met beperkte aansprakelijkheid;
- in France:
la société à responsabilité limitée;

- in Italy:
la società a responsabilità limitata;
- in Luxembourg:
la société à responsabilité limitée;
- in the Netherlands:
de besloten vennootschap met beperkte aansprakelijkheid.

2. Until the safeguards required of credit institutions and insurance companies are in due course coordinated, it shall be permissible for the Member States not to apply the provisions of this Directive to those undertakings.

SECTION 1

General Requirements

Article 2

1. The annual accounts shall comprise the balance sheet, the profit and loss account and the notes on the accounts. These documents shall constitute a composite whole.
2. The annual accounts shall conform to the principles of regular and proper accounting.
3. They shall be drawn up clearly and, in the context of the provisions regarding the valuation of assets and liabilities and the lay-out of accounts, shall reflect as accurately as possible the company's assets, liabilities, financial position and results.

SECTION 2

Lay-out of the annual accounts

Article 3

The lay-out of the balance sheet and of the profit and loss account, particularly as regards the form adopted for their presentation, may not be changed from one year to the next. Departures from this principle shall be permitted in exceptional cases. Where it is departed from, an indication thereof shall be given in the notes on the accounts together with an explanation of the reasons therefore.

Article 4

1. In the balance sheet, and also in the profit and loss account, the items referred to in Articles 8, 9, and 20 to 23 of this Directive shall be shown separately. A more detailed sub-division of the items that are preceded by Arabic numerals is authorized.
2. In exceptional cases a different lay-out shall, where the special nature of the undertaking so requires, be permitted for the balance sheet and profit and loss account items that are preceded by Arabic numerals. Any such different lay-out shall, however, present an equivalent view and be explained in the notes on the accounts.
3. The Member States may authorize a regrouping of the balance sheet and profit and loss account items that are preceded by Arabic numerals where they are of secondary interest only in relation to the object of Article 2(3) of this Directive.
4. In respect of each balance sheet and profit and loss account item the figures for the preceding financial year shall be shown.

Article 5

The Member States may authorize adaptation of the lay-out of the balance sheet and profit and loss account in order to bring out the allocation of the results.

Article 6

Any set-off between assets and liabilities, or between expenditure and income, is prohibited.

SECTION 3

Balance sheet lay-out

Article 7

For the presentation of the balance sheet, the Member States shall introduce into their legislation the lay-outs prescribed by Articles 8 and 9 of this Directive, and shall leave the companies to choose between them.

Article 8

Assets

- A. *Subscribed capital UNPAID*
 - *of which there has been called.*
- B. *Formation expenses in so far as the national law permits them to be recorded as assets.*
- C. *Fixed assets:*
 - I. *Intangible assets:*
 - 1. *Cost of research and development, in so far as the national law permits them to be recorded as assets,*
 - 2. *Concessions, patents, licences, trade marks, and similar rights and values, if they were:*
 - (a) *acquired for valuable consideration and are not to be shown under C I 3,*
 - (b) *created by the undertaking itself, in so far as the national law permits them to be recorded as assets,*
 - 3. *Goodwill, to the extent that it was acquired for valuable consideration,*
 - 4. *Payments on account.*
 - II. *Tangible assets:*
 - 1. *Land and buildings,*
 - 2. *Plant and machinery,*
 - 3. *Other fixtures, tools and equipment,*
 - 4. *Payments on account and tangible assets in process of construction.*
 - III. *Participating Interests and other financial assets:*
 - 1. *Holdings in associated undertakings,*
 - 2. *Claims on associated undertakings,*
 - 3. *Participating interests,*
 - 4. *Claims on undertakings with which the company is associated by virtue of a participating interest,*
 - 5. *Securities ranking as fixed assets,*
 - 6. *Other claims,*

7. Own shares (indicating their nominal value or proportionate value) to the extent that the national law permits them to be included in the balance sheet.

D. *Current assets:*

I. Stocks:

1. Raw and auxiliary materials,
2. Goods in course of production and waste products,
3. Finished products and stock in hand,
4. Payments on account.

II. Debtors:

(Amounts becoming due and payable within one year shall be shown separately for each item)

1. Claims in respect of sales and services rendered,
2. Claims on associated undertakings,
3. Claims on undertakings in which the company has a participating interest,
4. Other claims.

III. Securities forming part of the current assets, and liquid assets:

1. Holdings in associated undertakings,
2. Bills of exchange,
3. Bank balances, postal cheque account balances, cheques and cash in hand,
4. Own shares (indicating their nominal value or proportionate value) to the extent that the national law permits them to be included in the balance sheet,
5. Other securities.

E. *Pre-payments.*

F. *Loss:*

- I. For the year,
- II. Brought forward.

Liabilities

A. *Subscribed capital.*

(The shares must be shown by classes, indicating their nominal value or proportionate value).

B. *Reserves:*

1. Legal reserve,
2. Share premium account,
3. Revaluation reserve,
4. Reserve for own shares,
5. Statutory reserves,
6. Optional reserves.

C. *Value adjustments to the extent that these do not appear among the assets or in the notes on the accounts:*

1. On formation expenses,
2. On intangible fixed assets,
3. On tangible fixed assets,
4. On participating interests and other financial assets,
5. On stocks,
6. On claims forming part of the current assets,
7. On securities forming part of the current assets and liquid assets.

(As regards the figures mentioned in items 2 to 7, a corresponding breakdown to that used on the assets side should be included).

D. *Provisions for contingencies and charges:*

1. Provisions for pensions and similar obligations,
2. Provisions for taxation including future taxation,
3. Other provisions.

E. *Creditors:*

(Amounts becoming due and payable within one year, amounts becoming due and payable after more than five years, and amounts covered by

valuable security furnished by the company, must be shown separately for each item)

1. Debenture loans, showing convertible loans separately,
2. Debts to credit institutions,
3. Payments received on account of orders,
4. Debts in respect of purchases and services received,
5. Debts represented by bills of exchange,
6. Debts to associated undertakings,
7. Debts to undertakings with which the company is associated by virtue of a participating interest,
8. Other creditors.

F. *Accruals.*

G. *Profit:*

- I. For the year,
- II. Brought forward.

Article 9

A. *Subscribed capital UNPAID*

— *of which there has been called.*

B. *Formation expenses in so far as the national law permits them to be recorded as assets.*

C. *Fixed assets:*

I. *Intangible assets:*

1. Cost of research and development, in so far as the national law permits them to be recorded as assets,
2. Concessions, patents, licences, trade marks, and similar rights and values, if they were:
 - (a) acquired for valuable consideration and are not to be shown under C I 3,
 - (b) created by the undertaking itself, in so far as the national law permits them to be recorded as assets,
3. Goodwill, to the extent that it was acquired for valuable consideration,
4. Payments on account.

II. Tangible assets:

1. Land and buildings,
2. Plant and machinery,
3. Other fixtures, tools and equipment,
4. Payments on account and tangible assets in process of construction.

III. Participating interests and other financial assets:

1. Holdings in associated undertakings,
2. Claims on associated undertakings,
3. Participating interests,
4. Claims on undertakings with which the company is associated by virtue of a participating interest,
5. Securities ranking as fixed assets,
6. Other claims,
7. Own shares (indicating their nominal value or proportionate value) to the extent that the national law permits them to be included in the balance sheet.

D. *Current assets:*

I. Stocks:

1. Raw and auxiliary materials,
2. Goods in course of production and waste products,
3. Finished products and stock in hand,
4. Payments on account.

II. Debtors:

(Amounts becoming due and payable within one year must be shown separately in each case)

1. Claims in respect of sales and services rendered,
2. Claims on associated undertakings,
3. Claims on undertakings with which the company is associated by virtue of a participating interest,
4. Other claims.

III. Securities forming part of the current assets, and liquid assets:

1. Holdings in associated undertakings,
2. Bills of exchange,
3. Bank balances, postal cheque account balances, cheques and cash in hand,
4. Own shares (indicating their nominal value or proportionate value) to the extent that the national law permits them to be included in the balance sheet,
5. Other securities.

E. *Pre-payments.*

F. *Debts becoming due and payable within one year:*

(Amounts covered by valuable security furnished by the company must be shown separately for each item)

1. Debenture loans, showing convertible loans separately,
2. Debts to credit institutions,
3. Payments received on account of orders,
4. Debts in respect of purchases and services received,
5. Debts represented by bills of exchange,
6. Debts to associated undertakings,
7. Debts to undertakings with which the company is associated by virtue of a participating interest,
8. Other debts.

G. *Current assets in excess of the debts becoming due and payable within one year.*

H. *Total amount of asset items after deduction of the debts becoming due and payable within one year.*

I. *Creditors for amounts becoming due and payable after more than one year:*

(Amounts becoming due and payable after more than five years and amounts covered by valuable security furnished by the company must be shown separately for each item)

1. Debenture loans, showing convertible loans separately,
2. Debts to credit institutions,
3. Payments received on account of orders,
4. Debts in respect of purchases and services received,
5. Debts represented by bills of exchange,
6. Debts to associated undertakings,
7. Debts to undertakings with which the company is associated by virtue of a participating interest,
8. Other creditors.

J. *Value adjustments to the extent that these do not appear in the notes on the accounts:*

1. On formation expenses,
2. On intangible fixed assets,
3. On tangible fixed assets,
4. On participating interests and other financial assets,
5. On stocks,
6. On claims in respect of current assets,
7. On securities forming part of the current assets and liquid assets.

(As regards the figures mentioned in items 2 to 7, a corresponding breakdown to that used under C and D should be included)

K. *Provisions for contingencies and charges:*

1. Provisions for pensions and similar obligations,
2. Provisions for taxation, including future taxation,
3. Other provisions.

L. *Accruals.*

M. *Subscribed capital.*

(The shares must be shown by classes, indicating their nominal value or proportionate value)

N. *Reserves:*

1. Legal reserve,
2. Share premium account,
3. Revaluation reserve,
4. Reserve for own shares,
5. Statutory reserves,
6. Optional reserves.

O. *Result for the year.*

P. *Results brought forward.*

Article 10

1. Where a component of the assets or liabilities pertains to several items in the balance sheet, its relationship to other items shall be indicated either under the item where it appears or in the notes on the accounts, unless such indication is not essential to the comprehension of the annual accounts.
2. Own shares and holdings in associated undertakings shall be shown only under the item respectively that relates thereto.

Article 11

All commitments by way of guarantee of any kind entered into for account of third parties shall, if there is no obligation to show them under liabilities, be clearly set out below the balance sheet or in the notes on the accounts, distinguishing between the various types of guarantee which the national law recognizes, and specifying what valuable security, if any, has been provided. Commitments of this kind existing in respect of associated undertakings shall be shown separately.

SECTION 4

Special provisions relating to certain items in the balance sheet

Article 12

1. Whether particular assets are to be classified as fixed assets or current assets shall depend upon the purpose for which they are intended.

2. Fixed assets shall comprise those elements which are intended to be used on a continuing basis to enable the undertaking to operate.

3. (a) Movements in the various items of fixed assets shall be shown in the balance sheet or in the notes on the accounts. To this end there shall be shown, starting with the initial purchase price or production cost, separately for each of the items of fixed assets, on the one hand the additions, disposals, transfers and upward corrections during the year, and on the other hand the cumulative value adjustments as at the date of the balance sheet. If the value adjustments are indicated in the balance sheet they may be shown under either assets or liabilities.

(b) Where at the time the first annual accounts are drawn up in accordance with this Directive, the purchase price or production cost of an element of fixed assets cannot be determined without untoward expense or delay, the residual value at the beginning of the year may be treated as the purchase price or production cost. Any use made of this provision must be mentioned in the notes on the accounts.

(c) In the case of application of Articles 30 and 31 of this Directive, the presentation of the movements in the various items of fixed assets referred to under (a) shall be supplemented by separate mention, for each of the various items, of the cumulative amounts at the date of the balance sheet, on the one hand of the differences referred to in Article 30(2) and in Article 31(2), and on the other hand of the additional value adjustments.

4. (a) Movements in the various items of current assets shall be presented in the balance sheet or the notes on the accounts. To this end there shall be shown, separately for each of the items of current assets, on the one hand the purchase price or production cost of the elements shown in the balance sheet, and on the other hand the value adjustments. If the value adjustments are indicated in the balance sheet they may be shown under either assets or liabilities.

(b) The provisions of paragraph 3 (c) shall apply to the presentation of the item relating to stocks.

5. The provisions of paragraph 3(a) and (b) shall apply to the presentation of the item "formation expenses".

Article 13

Under the item "land and buildings" shall be shown land not built on as well as the land built on and the buildings thereon, together with fixtures and fittings.

Where national law authorizes the inclusion under assets of rights in real estate which are of like nature to rights of ownership, they shall be included under the item "land and buildings".

Article 14

The term "participating interests" is used in this Directive to mean rights in the capital of other undertakings, whether or not represented by certificates which by creating a durable link with them, are intended to contribute to the activities of the company. A holding of 10% of the subscribed capital of another undertaking shall be presumed to constitute a participating interest.

Article 15

Under "Pre-payments" on the assets side shall be shown expenditure incurred during the year but relating to a subsequent year, together with the earnings relating to the year to the extent that they will not be received until after the close of the year. The latter, however, may also be shown under debtors.

Article 16

The value adjustments are adjustment items relating to elements of assets and are intended to take account of depreciation established in respect of those elements at the date of the balance sheet, whether that depreciation is definitive or not.

Article 17

The provisions for contingencies and charges are intended to cover either the certain cost of major maintenance work or of major repairs which will be incurred in the course of subsequent years, or losses or charges the nature of which is clearly defined but which at the date of the balance sheet are either likely to be incurred, or are certain to be incurred but are indeterminate as to amount or as to the date on which they will arise.

The provisions for contingencies and charges shall not be used to adjust the value of elements of assets.

Article 18

Under "Accruals" on the liabilities side shall be shown income received before the date of the balance sheet but attributable to a subsequent year, together with charges which, though relating to the year in question, will only be paid in the course of a subsequent year. The latter, however, may also be shown under creditors.

SECTION 5

Lay-out of the Profit and Loss Account

Article 19

For the presentation of the profit and loss account, the Member States shall adopt into their laws the lay-outs appearing in Articles 20 to 23 of this Directive, and shall leave the companies to choose between them.

Article 20

- I. Operating result (excluding any earnings and changes shown under II):
 1. Net turnover,
 2. Changes in stocks of finished and semi-finished products,
 3. Work effected by the undertaking for its own account and shown under assets,
 4. Other operating receipts,
 5. Cost of raw and auxiliary materials,
 6. Staff costs,
 7. (a) Value adjustments in respect of formation expenses and of tangible and intangible fixed assets,
(b) Value adjustments in respect of elements of current assets,
 8. Other operating expenses,
 9. Operating result.
- II. Financial result:
 10. Earnings from participating interests, showing separately those derived from associated undertakings,
 11. Earnings from other securities and from claims forming part of the fixed assets, showing separately those derived from associated undertakings,
 12. Other interest and similar earnings, showing separately those derived from associated undertakings,
 13. Value adjustments in respect of participating interests and other financial assets and of securities forming part of the current assets,

14. Interest and similar charges, showing separately those concerning associated undertakings,

15. Financial result.

III. Exceptional result

16. Exceptional earnings,

17. Exceptional charges,

18. Exceptional result,

19. Sub-total.

IV. Taxes:

20. Taxes on the result:

— actual,

— future,

21. Other taxes not shown under I, II or III above.

V. Result for the year.

Article 21

A. *Charges*

I. Operating expenses (excluding any shown under II):

1. Reduction in the stock of finished and semi-finished products,

2. Cost of raw and auxiliary materials,

3. Staff costs,

4. (a) Value adjustments in respect of formation expenses and of tangible and intangible fixed assets,

(b) Value adjustments in respect of elements of current assets.

5. Other operating expenses.

II. Financial charges:

1. Value adjustments in respect of participating interests and other financial assets and of securities forming part of the current assets,

2. Interest and similar charges, showing separately those concerning associated undertakings.

III. Exceptional charges.

IV. Taxes:

1. Taxes on the result:
 - actual,
 - future,
2. Other taxes not shown under I, II and III above.

V. Result for the year.

B. *Receipts*

I. Operating receipts (excluding any shown under II):

1. Net turnover,
2. Increase in stocks of finished and semi-finished products,
3. Work effected by the undertaking for its own account and shown under assets,
4. Other operating receipts.

II. Financial earnings:

1. Earnings from participating interests, showing separately those derived from associated undertakings,
2. Earnings from other securities and from claims forming part of the fixed assets, showing separately those derived from associated undertakings,
3. Other interest and similar earnings, showing separately those derived from associated undertakings.

III. Exceptional earnings.

IV. Result for the year.

Article 22

I. Operating result (excluding any earnings and charges shown under II):

1. Net turnover,
2. Production costs of output supplied and making-up the turnover (including value adjustments),

3. Gross result achieved from turnover,
4. Distribution expenses (including value adjustments),
5. Administrative expenses (including value adjustments),
6. Other operating receipts,
7. Operating result.

II. Financial result:

8. Earnings from participating interests, showing separately those derived from associated undertakings,
9. Earnings from other securities and from claims forming part of the fixed assets, showing separately those derived from associated undertakings,
10. Other interest and similar earnings, showing separately those derived from associated undertakings,
11. Value adjustments in respect of participating interests and other financial fixed assets and of securities forming part of the current assets,
12. Interest and similar charges, showing separately those concerning associated undertakings,
13. Financial result.

III. Exceptional result:

14. Exceptional earnings,
15. Exceptional charges,
16. Exceptional result,
17. Sub-total.

IV. Taxes:

18. Taxes on the result:
 - actual,
 - future,
19. Other taxes not shown under I, II or III above.

V. Result for the year.

Article 23

A. *Charges*

- I. Operating expenses (excluding any shown under II):
 1. Production costs of output supplied and making-up the turnover (including value adjustments),
 2. Distribution expenses (including value adjustments),
 3. Administrative expenses (including value adjustments).
- II. Financial charges:
 1. Value adjustments in respect of participating interests and other financial fixed assets and of securities forming part of the current assets,
 2. Interest and similar charges, showing separately those concerning associated undertakings.
- III. Exceptional charges.
- IV. Taxes:
 1. Taxes on the result:
 - actual,
 - future,
 2. Other taxes not shown under I, II or III above.
- V. Result for the year.

B. *Receipts*

- I. Operating receipts (excluding any shown under II):
 1. Net turnover,
 2. Other operating receipts.
- II. Financial earnings:
 1. Earnings from participating interests, showing separately those derived from associated undertakings,

2. Earnings from other securities and from claims forming part of the fixed assets, showing separately those derived from associated undertakings,
3. Other interest and similar earnings, showing separately those derived from associated undertakings.

III. Exceptional earnings.

IV. Result for the year.

Article 24

The Member States may authorize companies for which at the date of the balance sheet:

- the balance sheet total reduced by the value adjustments, if these are entered under liabilities, does not exceed one million units of account,
- the net turnover does not exceed two million units of account,
- the average number of employees during the year did not exceed one hundred,

to adopt lay-outs different from those appearing in Articles 20 to 23 of this Directive within the following limits:

- a) in Article 20, under I, items 1 to 5 inclusive may be grouped together under one item called Gross result;
- b) in Article 21, items AI, 1 and 2, and BI, 1 to 4 inclusive may be grouped together under one item called Gross earnings or Gross charges as the case may be;
- c) in Article 22, under I, items 1, 2, 3 and 6 may be grouped together under one item called Gross result;
- d) in Article 23, items AI, 1 and BI, 1 and 2, may be grouped together under one item called Gross earnings or Gross charges as the case may be.

If subsequently any one of the numerical limits set out above is exceeded, the exemptions provided for in this provision may again be applied only if all the conditions specified above are satisfied for two consecutive years.

The amounts in units of account specified in this provision may vary by not more than 10% up or down for purposes of conversion into national currencies.

SECTION 6

Special provisions relating to certain items in the profit and loss account

Article 25

The net amount of turnover includes receipts from sales of products, goods and services falling within the usual operations of the company, after allowing for any price-reduction in respect of those sales, and for value-added tax and other taxes directly tied to the turnover.

Article 26

1. Under the items Exceptional earnings and Exceptional charges, shall be shown earnings and charges that are attributable to another year, together with any earnings and charges that do not arise out of the usual operations of the undertaking.
2. Unless such earnings and charges are of no importance in the assessment of the results, explanations of their amount and nature shall be given in the notes on the accounts.

Article 27

Under the item Taxes on the Result shall be shown the actual amount of taxes payable for the year, and separately, the amount of the future liability to tax.

SECTION 7

Valuation Rules

Article 28

1. The Member States shall ensure that the valuation of the items shown in the annual accounts is made in accordance with the following general principles:
 - a) The methods of valuation may not be changed from one year to another.
 - b) Only the profits earned at the date of the balance sheet may be included in it; account shall nevertheless be taken of all contingencies foreseeable at that date.

c) Account shall be taken of any deficiencies that do not become apparent until after the date of the balance sheet, but before it is drawn up, if they arose in the course of the year to which the annual accounts relate.

d) Account shall be taken of any depreciation, whether the year closes with a loss or with a profit.

e) The components of the asset and liability items shall be valued separately.

f) The balance sheet at the close of one year shall correspond to the opening balance sheet for the following year.

2. Departures from these general principles shall be permitted in exceptional cases. Where they are departed from, an indication thereof shall be given in the notes on the accounts together with an explanation of the reasons and an assessment of the effect on the assets, liabilities, financial position and result.

Article 29

The valuation of the items shown in the annual accounts shall be made in accordance with Articles 32 to 39 of this Directive, based on purchase price or production cost.

Article 30

1. Notwithstanding the provisions of Article 29 of this Directive, the Member States may authorize valuation on the basis of replacement value for tangible fixed assets with a limited useful life, and for stocks.

They shall make provision that in cases where this method is employed an indication thereof shall be given in the notes on the accounts, specifying the items concerned, and that the use of that method is justified as regards the value shown.

2. Where paragraph 1 is applied the amount of the difference in valuation on the basis of replacement value and valuation in accordance with the general rule contained in Article 29 shall be shown under liabilities in the item Revaluation Reserve. This item shall be sub-divided into:

- Reserve for tangible fixed assets,
- Reserve for stocks.

3. The Revaluation reserve may be capitalized at any time.

4. The Revaluation reserve shall be reduced to the extent that the amounts transferred thereto are no longer required for the purpose of replacement of the asset items concerned. The amounts in question shall be added to the result for the year. They shall be shown separately in the profit and loss account.
5. Save as provided in paragraphs 3 and 4 the Revaluation reserve shall not be reduced.
6. The value adjustments shall be calculated each year on the basis of the replacement value adopted for the year in question.

Article 31

1. Notwithstanding Article 29 of this Directive the Member States may authorize revaluation of the tangible fixed assets and of the participating interests and other financial assets.

They shall make provision that in cases where revaluation takes place an indication thereof shall be given in the notes on the accounts, specifying the items concerned and that the making of the revaluation is justified as regards the value shown.

2. In the event of paragraph 1 being applied, the amount of the difference in valuation made in accordance with paragraph 1 above and the valuation made in accordance with the general rule contained in Article 29 shall be shown under liabilities in the Revaluation Reserve. This item shall be sub-divided into:

- Reserve for tangible fixed assets,
- Reserve for participating interests and other financial assets.

3. The Revaluation reserve may be capitalized at any time.
4. The Revaluation reserve shall be reduced to the extent that the increases in value concerned have been actually realised. The amounts in question shall be added to the result for the year. They shall be shown separately in the profit and loss account.
5. Save as provided in paragraphs 3 and 4 the Revaluation reserve shall not be reduced.

Article 32

1. (a) Where the national law authorizes the inclusion of formation expenses under assets, they shall be written off over a maximum period of five years.

(b) In so far as the formation expenses have not been completely written off, no distribution of profits shall take place unless the amount of the optional reserves is at least equal to the amount of the expenses not written off.

2. The amounts entered under this item shall be explained in the notes on the accounts.

Article 33

1. (a) The items of fixed assets shall, without prejudice to the provisions of (b) and (c) below, be valued at purchase price or production cost.

(b) The purchase price or production cost of the items of fixed assets which have a limited useful life shall be reduced by value adjustments calculated according to a method that satisfies the requirements of good management.

(c) (aa) Value adjustments may be made in respect of the items of fixed assets, whether or not their useful life is limited, so that they are valued at the lowest figure attributable to them at the date of the balance sheet.

(bb) Value adjustments shall be made if the depreciation in value is expected to be permanent.

(cc) The value adjustments referred to in (aa) and (bb) shall be shown separately in the profit and loss account or in the notes on the accounts.

(dd) Valuation at the lowest value provided for in (aa) and (bb) shall be discontinued if the reasons for which the value adjustments were made have ceased to apply.

(d) If the items of fixed assets are the subject of exceptional value adjustments under fiscal law, the amount of the adjustments shall be indicated in the notes on the accounts.

2. The purchase price shall be calculated by adding to the price paid the expenses incidental thereto.

3. (a) The production cost shall be calculated by adding to the purchase price of the raw and auxiliary materials the manufacturing costs directly attributable to the product in question.

(b) A reasonable proportion of the manufacturing costs which are only indirectly attributable to the product in question may be added to the production cost to the extent that they relate to the period of manufacture.

(c) Costs of distribution shall not be included in production cost.

4. (a) The Member States may authorize the inclusion in production cost of interest on capital borrowed to finance the manufacture of fixed assets to the extent that it relates to the period of such manufacture. In that event they shall make provision for an indication to be given in the notes on the accounts that such interest is included under assets.

(b) They may also authorize the inclusion in the production cost of interest on own capital utilized for the purpose of financing the manufacture of fixed assets to the extent that it relates to the period of such manufacture. In that event they shall make provision for the amount thereof to be shown in the notes on the accounts.

Article 34

1. Article 32 of this Directive shall apply to the item "Cost of research and development".
2. Article 32(1) (a) shall apply to item C I 3 under Articles 8 and 9.

Article 35

Tangible fixed assets, raw and auxiliary materials, which are constantly being replaced and of which the overall value is of secondary importance to the undertaking may be shown under assets at a fixed quantity and value, if the quantity, value and composition thereof do not vary appreciably.

Article 36

1. (a) The items of current assets shall be valued at purchase price or production cost, without prejudice to the provisions of (b) and (c) below.
(b) Value adjustments shall be made in respect of the items of current assets so that they are valued at the lowest figure attributable to them at the date of the balance sheet.
(c) The Member States may authorize exceptional value adjustments if, on the basis of a reasonable commercial assessment, these are necessary so that the valuation of these items does not have to be modified in the near future because of fluctuations in value. The amount of these value adjustments shall be shown separately in the profit and loss account or in the notes on the accounts.

(d) Valuation at the lowest value provided for in (b) and (c) shall be discontinued if the reasons for which the value adjustments were made have ceased to apply.

(e) If the items of current assets are the subject of exceptional value adjustments under fiscal law, the amount of the adjustments shall be indicated in the notes on the accounts.

2. The definitions of purchase price and of production cost contained in Article 33(2) to (4) shall apply.

Article 37

The purchase price or production cost of stocks of goods in the same category may also be calculated either on the basis of weighted average prices or by the "First in—first out" (Fifo) method or "Last in—first out" (Lifo) method, or some similar method.

Article 38

1. Where the amount of any debt repayable is greater than the amount received, the difference may be shown as an asset. It shall be shown separately in the balance sheet or in the notes on the accounts.

2. The amount of such difference shall be written off not later than the time when repayment of the debt is made.

Article 39

Provisions for contingencies and charges shall not exceed in amount the sums which a reasonable businessman would consider necessary.

The provisions shown in the balance sheet under the item "Other provisions" shall be specified in the notes on the accounts if they are at all substantial.

SECTION 8

Contents of the notes on the accounts

Article 40

The notes on the accounts shall contain commentary on the balance sheet and profit and loss account in such manner as to give as true and fair a view as possible of the company's assets, liabilities, financial position and results.

Article 41

In addition to the information required under other provisions of this Directive, the notes on the accounts shall set out information in respect of the following matters in any event:

1. The valuation methods applied to the various items in the annual accounts, and the methods employed in calculating the value adjustments;
2. The name and head office address of each of the undertakings in which the company holds at least 10% of the capital, showing the proportion of the capital held and the amount of the subscribed capital, the amount of the reserves and the results for the latest business year of the undertaking concerned;
3. The way in which the authorized capital has been employed, if any such capital has been created;
4. Whether there are any entitlements carrying the right to a share of profits, and whether there are any convertible debentures or similar securities or rights, specifying the number thereof and what rights they confer;
5. The overall amount of the financial commitments that are not shown in the balance sheet, in so far as this information is of assistance in assessing the financial position. Commitments existing with regard to associated undertakings shall be shown separately;
6. The whole of the personnel costs relating to the accounting period unless they are shown separately in the profit and loss account;
7. The taxes included in the operating result, the financial result or exceptional result;
8. The amount of the changes in the result for the year due to the application of fiscal laws;
9. The amount of the emoluments granted during the year to the members of the administrative, managerial and supervisory bodies by reason of their responsibilities, showing the total for each category;
10. The amount of advances and credits granted to the members of administrative, managerial and supervisory bodies, and commitments entered into on their account by way of guarantees of any kind, showing the total for each category.

Article 42

The Member States may allow the particulars prescribed by Article 41(2):

- (a) to take the form of a statement deposited in accordance with Article 3, paragraphs 1 and 2 of Directive 68/151/EEC of 9 March 1968. This shall be mentioned in the notes on the accounts.
- (b) to be omitted when their nature is such that, in the view of a reasonable business man, they would be seriously prejudicial to any of the undertakings to which this provision relates. The omission of the particulars shall be mentioned in the notes on the accounts.

SECTION 9

Contents of the annual report

Article 43

1. The annual report shall contain a detailed review of the development of the company's business and of its position.
2. The report shall also give particulars of:
 - (a) any important events that have occurred since the close of the business year;
 - (b) the company's likely future development.

SECTION 10

Publication

Article 44

1. The annual accounts duly approved and the annual report, together with the report submitted by the person responsible for auditing the accounts, shall be deposited without delay in accordance with Article 3(1) and (2) of Directive 68/151/EEC of 9 March 1968.
2. In derogation from Article 3(4) of that Directive, the annual accounts shall be published in full in a national gazette designated by the Member State. The report submitted by the person responsible for auditing the accounts shall be published therein at the same time.

3. The annual report shall be published in accordance with the requirements of Article 3(4) of the Directive referred to in paragraph 1.

Article 45

On any other occasion when publication is made in full, the annual accounts and report shall be reproduced in the form and text on the basis of which the person responsible for auditing the accounts drew up his report. They shall be accompanied by the full text of the certificate. If the person responsible for auditing the accounts made any qualifications or refused to certify the accounts, the fact shall be stated and the reasons given.

Article 46

If the annual accounts are not published in full, it shall be pointed out that the version published is abridged, and reference shall be made to the national gazette in which they were published. The certificate of the person responsible for auditing the accounts shall not accompany this publication, but it shall be stated whether the certificate was made with or without qualification, or was refused.

Article 47

There shall be published along with the annual accounts, and in like manner:

- the proposed allocation of the results,
- the allocation of the results

in cases where these items do not appear in the annual accounts.

SECTION 11

Special provisions relating to the société à responsabilité limitée, the Gesellschaft mit beschränkter Haftung, the Società a responsabilità limitata and the Vennootschap met beperkte aansprakelijkheid

Article 48

The companies referred to in Article 1(1) (b) shall draw up their annual accounts and report for the information of their members in accordance with

the requirements of Articles 2 to 23 and 25 to 43 of this Directive, subject to the following qualifications:

(a) In Article 8 a separate item, "Claims on members", shall be included under assets at C III and D II and a further separate item, "Debts to members"; under liabilities at E;

(b) In Article 9 a separate item, "Claims on members", shall be included at C III and D II and a further separate item, "Debts to members at F and I.

Article 49

1. The companies referred to in Article 1, (1) (b) shall cause their annual accounts and report to be audited by one or more persons authorized by the law of the country to audit accounts.

2. The Member States may exempt from the obligation imposed under paragraph 1 companies of which at the date of their balance sheet:

- the balance sheet total reduced by the value adjustments, if these are entered under liabilities, does not exceed one hundred thousand units of account,
- the net turnover as defined in Article 25 of this Directive does not exceed two hundred thousand units of account,
- the average number of employees during the year did not exceed twenty.

In that case they shall introduce appropriate sanctions into their law for cases in which the annual accounts and reports of such companies are not drawn up in accordance with the requirements of this Directive.

If subsequently any one of the numerical limits set out above is exceeded, the exemption provided for in this provision may again be applied only if all the conditions specified above are satisfied for two consecutive years.

The amounts in units of account specified in this provision may vary by not more than 10% up or down for purposes of conversion into national currencies.

Article 50

1. (a) The companies referred to in Article 1(1) (b) shall publish their annual accounts and report, and the report drawn up by the person responsible for auditing the accounts, in accordance with Article 44 of this Directive.

(b) Articles 45 to 47 of this Directive shall equally apply to the companies referred to in paragraph 1(a).

2. Notwithstanding paragraph 1(a), the Member States may permit

(a) companies other than those referred to in Article 49(2), in the case of which at the date of their balance sheet:

- the balance sheet total reduced by the value adjustments, if these are entered under liabilities, does not exceed one million units of account;
- the net turnover as defined in Article 25 of this Directive does not exceed two million units of account;
- the average number of employees during the year did not exceed one hundred,

to publish their profit and loss account in the abridged form provided for in Article 24 of this Directive. If subsequently any one of the numerical limits set out above is exceeded, the exemption provided for in this provision may again be applied only if all the conditions specified above are satisfied for two consecutive years.

The amounts in units of account specified in this provision may vary by not more than 10% up or down for purposes of conversion into national currencies.

(b) the companies referred to in Article 49(2) of this Directive to publish merely an abridged balance sheet showing only the items preceded by letters and Roman numerals set out in Articles 8 and 9 with separate particulars of the claims on and debts to members and notes on the accounts but not necessarily including the explanations required under Article 41(4) to (10);

(c) the publication requirements laid down for the companies referred to in (a) and (b) to be effected in manner prescribed by Article 3 of Directive 68/151/EEC of 9 March 1968.

SECTION 12

Final provisions

Article 51

1. (a) The Member States shall, within eighteen months of notification of this Directive, make all the necessary amendments to their laws, regulations and administrative provisions so as to comply with the provisions of this

Directive, and shall inform the Commission thereof immediately. They shall bring the amendments into force within thirty months of notification of this Directive.

(b) The Governments of the Member States shall communicate to the Commission for information the draft texts of the laws and regulations together with the statements of grounds, relating to the matters covered by this Directive. These shall be communicated at least six months before the date envisaged for final adoption of the texts.

2. The obligation to show in the annual accounts the items prescribed by Articles 8, 9 and 20 to 23 which relate to associated undertakings, and the obligation to provide information concerning these undertakings in accordance with Articles 10(2), 11 or 41(5) of this Directive shall enter into force simultaneously with a Council Directive relating to consolidated accounts.

Article 52

This Directive is addressed to the Member States.

STATEMENT OF GROUNDS

At the present moment considerable differences exist in the Member States as regards the legal requirements governing both the structure and content of companies' annual accounts. The particulars that the companies have to furnish are plainly at variance, both qualitatively and quantitatively, from one country to another.

This situation may be prejudicial to the fusion of national markets into a common market operating as an internal market. The idea of the Common Market implies that all companies having the same legal form can work in the Community under comparable legal conditions. It is a question of equality of opportunity as regards the law. Otherwise competition in the different Member States between companies having the same legal form will continue to be distorted artificially.

Persons who intend to establish relations with companies in other Member States, or who have already done so, have the greatest interest in being able to obtain sufficient and comparable information concerning the assets, financial position and results of such companies. At present the annual accounts of companies established in different Member States are far from being comparable, partly because the nomenclature currently in use in the different Member States for the items in balance sheets and profit and loss accounts is often totally different. In most cases the reader of a balance sheet, while being quite familiar with the structure of the accounts and the terminology employed in his own country, is not able to analyse the annual accounts of companies in other Member States. These circumstances might be enough to stop anyone from taking the risk of forming commercial ties with these companies.

The differences that exist between national laws as regards presentation of accounts can also provide a reason for companies—in choosing where they will establish themselves—to choose a country where the requirements in this matter are not very stringent.

Finally, these differences may also be prejudicial to the rational orientation of capital investment in the Community to the extent that investors are not in possession of sufficient comparable information to take their decisions in full knowledge of the facts. This is particularly true as regards purchase of shares in companies in other Member States.

Article 54(3) (g) of the EEC Treaty, which lays down an obligation to coordinate, with a view to rendering them equivalent, the safeguards required of companies in the Member States in order to protect the interests both of members and of third parties, forms the legal basis of this proposal for a Directive. It would in fact be the fourth Directive to be produced on the

basis of that requirement. The first Directive (No. 68/151/EEC of 9 March 1968, *Journal Officiel* L 65 of 14 March 1968) coordinates the said safeguards in the three following fields: disclosure of important information relating to the company, validity of commitments entered into by the company, and invalidity of the company. It applies to sociétés anonymes, sociétés en commandite par actions and sociétés à responsabilité limitée.¹

On 9 March 1970 the Commission submitted to the Council a proposal for a second Directive for coordination of safeguards required for formation of a société anonyme,¹ and for maintenance of and changes in the capital (*Journal Officiel* No. C 48 of 24 April 1970). The proposal for a third Directive for coordination of safeguards required in the event of the amalgamation of sociétés anonymes¹ under the law of a single Member State was submitted to the Council on 6 June 1970 (*Journal Officiel* No. C 89 of 14 July 1970).

This proposal for a fourth Directive is to coordinate the safeguards required in the Member States as regards the structure and content of the annual accounts and management report, methods of valuation and publication of those documents. It applies to sociétés anonymes, sociétés en commandite par actions and sociétés à responsabilité limitée.¹

Directive No. 68/151/EEC of 9 March 1968 only contains provisions regarding formal disclosure: it prescribes what documents and particulars must be published, the manner of disclosure, the opposability to third parties of the particulars disclosed etc. This present Directive governs the material aspects of publication, that is to say the content of the information to be published, particularly of the balance sheet and profit and loss account. Under Article 2(1) (f) of Directive No. 68/151/EEC of 9 March 1968 sociétés anonymes and sociétés en commandite par actions¹ are already obliged to publish their annual accounts. Compulsory disclosure of the annual accounts of sociétés à responsabilité limitée¹ was confirmed as a matter of principle by that same provision but it will not be applied until this Directive enters into force and determines to what extent such disclosure is required.

The provisions of this Directive, which must be absolutely observed, may when taken as a whole prove to be not entirely satisfactory for presenting the desired image of the company in certain marginal cases. In such cases it will be necessary by virtue of the principles established at the beginning of the Directive, which are equally compulsory, for the facts set out to be enlarged on sufficiently so that all the appropriate particulars of the actual position of the undertaking are provided.

¹ These French terms are for convenience used in parts of this Statement of Grounds to include all the corresponding types of company specified in Article 1 of this proposal for a Directive.

Moreover, when the text permits any departure from the said provisions, every precaution has been taken to make it possible, by making it compulsory to provide a certain number of additional facts and explanations, to arrive at a clear understanding, quantitatively and qualitatively, of the differences that the departures entail. In this way, the requirement that the reader of the documents in question should be informed of the manner in which the figures presented to him have been arrived at, has also been satisfied.

The requirements of this Directive relate to the annual accounts to be established in accordance with commercial law. They in no way affect the special regulations of a fiscal nature which determine the financial and economic data that have to be supplied to the tax authorities.

Article 1

The coordination measures prescribed by Articles 2 to 47 of the Directive apply to Sociétés anonymes and to Sociétés en commandite par actions.¹ The coordination measures that apply to Sociétés à responsabilité limitée¹ are contained in section 11, Articles 48 to 50. It follows from Article 2(1) (f) of Directive No. 68/151/EEC of 9 March 1968 that this Directive must coordinate the safeguards relating to presentation of accounts for these three forms of company at the same time.

As regards the Netherlands the Directive applies also to the besloten vennootschap met beperkte aansprakelijkheid. This new legal form which has recently been introduced into Dutch law in consequence of the application of Directive No. 68/151/EEC of 9 March 1968, replaces the besloten naamloze vennootschap referred to in Article 2 of the Directive of 9 March 1968.

Paragraph 2 permits the Member States not to apply the provisions of this Directive to credit institutions and insurance companies. This exemption is justified by the fact that full application of the Directive to those companies is not possible. The special nature of these undertakings calls for a certain number of special provisions in the matter of the establishment of accounts, such as in fact exist in most of the Member States. In order not to delay the adoption of this Directive, such provisions, the preparation of which calls for further study, will be laid down in a later Directive. However, it should be pointed out right away that the information required from those companies should be at least equivalent to that called for by this Directive, of which moreover the majority of the articles, and especially the provisions of a general nature, could be applied to those companies.

¹ See note on page 45.

SECTION 1

General provisions

Article 2

The first paragraph of this Article defines the concept of annual accounts. They comprise the balance sheet, the profit and loss account and the notes on the accounts. It has been expressly added that these documents form a composite whole. The importance of the notes on the accounts is thus underlined as a necessary complement for a proper understanding of the balance sheet and the profit and loss account.

The annual accounts must satisfy the requirements of regular and proper accounting (par. 2). It is not considered useful or appropriate to define these principles more precisely, as no clear delimitation of their content and scope can be made. Some codification of these principles in accordance with developments in theory and practice will fall to be made rather by the various professional organizations that exist in the Member States.

Paragraph 3 defines the general purpose of the provisions relating to the annual accounts. To give as accurate a picture as possible of the assets and liabilities, financial position and results of the company; such is the principal aim that must always be followed in drawing up the annual accounts and which must guide the choice between the different possibilities available under the provisions dealing with valuation and the structure of the accounts. Moreover, these provisions, which are compulsory, might in certain circumstances prove to be not quite suitable for showing adequately the true situation of the undertaking. They will thus require to be supplemented by adequate commentary if the objects set out above are to be suitably achieved.

SECTION 2

Structure of the annual accounts

Article 3

This Article affirms the principle of continuity in the structure of the annual accounts so that they are comparable over a period of time. It goes without saying that companies cannot without good cause change the lay-out of balance sheets and profit and loss accounts or the presentation of these documents from one year to another. The different ways in which the

balance sheet and the profit and loss account can be presented are laid down in Articles 8 and 9 and in Articles 20 to 23.

It is not possible to exclude any departure from these principles. A company producing a wide range of products for example will have to be allowed to change the structure of the items of its annual accounts when a substantial change in the relationship between its various branches of activity calls for a structure more in line with the new situation (see Art. 4(2)).

As regards the rules of valuation, the principle of continuity is dealt with in Article 28(1) (a).

Article 4

For the balance sheet, as for the profit and loss account, minimum requirements have been established which are in principle compulsory. One can thus be sure that the information given to shareholders and third parties regarding companies in other Member States will be equivalent to that which they receive in their own country.

Account has been taken in various ways of one objection that might be raised. It might in fact be argued that the lay-outs, by reason of their mandatory nature, are not flexible enough, and that for this reason the annual accounts might present a less exact picture than is desirable. In consequence a more detailed sub-division of the items that are preceded by Arabic numerals is always permitted if this would help to increase the quality of the information supplied (par. 1). Furthermore, a different lay-out—as regards the items preceded by Arabic numerals—is authorized in exceptional cases if the particular nature of the undertaking demands it for reasons of clarity, or if the material facts on which the lay-out is based are lacking. But these exceptions are as a general rule of minor importance in relation to the general lay-outs which have been arrived at by reference to the needs of industrial and commercial undertakings; consequently the exceptions take account of the particular requirements of certain undertakings only (for example, mining undertakings, shipping companies, etc.).

If an item that is preceded by an Arabic numeral is only of secondary importance in assessing the company's position, to show it separately does not seem absolutely necessary. It is for this reason that the Member States can authorize the grouping together of such items (par. 3).

By showing the corresponding figures for the preceding year, as prescribed by paragraph 4, it will be possible to make a comparison of how the company has developed over a period of time.

Article 5

There is no uniform practice in the Member States as regards the presentation and publication of the allocation of the results. In one of the Member States, companies are obliged by law to show this information in part in the profit and loss account; in other Member States it appears in the balance sheet. It is also possible for a clear distinction to be made between the annual accounts and the allocation of the results, so that the latter is shown only indirectly.

It has not been considered essential to prohibit either of these practices, provided the information given is the same, that is to say that in each Member State companies are obliged to publish the allocation of the results. Articles 5 and 47 ensure this.

The system adopted in these Articles is as follows: under Article 5 the Member States may allow companies to show the allocation of the results in the balance sheet or in the profit and loss account; if the allocation is not shown in the annual accounts, Article 47 requires it to be published at the same time as the annual accounts and in the same way.

Articles 5 and 47 do not speak of the allocation of the result for the year but of the allocation of the results. Indeed, all or part of the amount to be allocated may be drawn from reserves or from results brought forward. How it is made up will depend on what allocation of the results is proposed. Article 47 requires the proposed allocation to be shown in the annual accounts or published at the same time as the annual accounts and in the same way.

SECTION 3

Structure of the balance sheet

Article 7

For presentation of the balance sheet the Member States are to allow companies to choose between the horizontal and narrative forms, of which Articles 8 and 9 contain the respective lay-outs. In the former case, the asset items and the liability items are arranged on opposite sides, the asset items appearing on the debit side and the liability items on the credit side. In the narrative form, the asset items and the liability items are set out in columnar form. The choice of the one method of presentation in preference to the other will not materially affect the making of comparisons between different companies.

Presentation in the horizontal form is the more widespread in practice. The narrative form, already in use in one Member State, is offered as an alternative, however, in the light of possible future developments.

Article 8

The assets side of the balance sheet is sub-divided into subscribed capital not paid up, formation expenses, fixed assets, current assets and prepayment accounts. The principle underlying this classification and the sub-divisions following it is that of grouping the elements that go to make up the assets according to their degree of liquidity, those which are generally the most difficult to convert into liquid funds and, the valuation of which is the least precise being shown at the top of the balance sheet.

Formation expenses (under B), the cost of research and development (under C I, 1), and concessions, patents etc. created by the undertaking itself (under C I, 2 *b*) cannot be entered or are not normally entered on the assets side of the balance sheet in certain Member States. It has not been thought necessary to prohibit altogether the inclusion of these elements in the balance sheet. Some items have been provided for this purpose in the lay-out but they are of an optional nature, which implies that if such elements are shown in the balance sheet they must of necessity appear under these items. In addition, for formation expenses and research costs particularly strict valuation rules are prescribed by Articles 32 and 34.

Various items in the lay-out relate to undertakings with which the company is associated by virtue of a participating interest (see under C III 4, D II 3 on the assets side and E 7 under liabilities). This formula relates both to undertakings in which the company drawing up the balance sheet has a participating interest, and to undertakings which have a participating interest in the company.

If the national law authorizes the inclusion of a company's own shares in the balance sheet, these must be shown either as fixed assets (under C III 7) or as current assets (under D III 4), according to whether the company wishes to retain the shares or sell them in the near future. In accordance with Article 20 of the proposal for a second Directive on the basis of Article 54(3) (g) (presented by the Commission to the Council on 9 March 1970, *Journal Officiel* No. C 48 of 24 April 1970), pursuant to which a permanent reserve of like amount must be shown on the liabilities side if the company's own shares are entered on the assets side, an item "Reserve for own shares" (see liabilities under B 4) has been included in the lay-out under reserves.

The balance sheet will reflect the company's financial position all the better as a result of the fact that for debtors—the same is true on the liabilities side as regards creditors—the time they have left to run must be shown; the

amounts under debtors and creditors that will become due and payable within not more than one year must be indicated separately for each of the items; in addition, debts that will become due and payable after more than five years must be shown separately. Although the determination of the period left to run can raise practical difficulties, in particular when, as a result of being extended, theoretically short-term credits become in fact medium or long-term credits (revolving credits), it seems advisable to mention the period left to run.

In the sub-division of reserves it seems right to show the share premiums separately, since they arise from contributions of capital. As for the revaluation reserve, reference may be made to Articles 30 and 31 and the explanations relating thereto.

It seems right to sub-divide the provisions for contingencies and charges into provisions for pensions, provisions for taxation and other provisions, as the economic character of each is different.

Under Creditors, those covered by valuable security must be shown separately. By this means, creditors and third parties will know to what extent the company's assets are subject to charges and to what extent other creditors have prior rights.

Article 9

This Article contains the lay-out of the balance sheet in narrative form. This form gives two additional pieces of information which are important for assessing the financial position of the company. These are the items G, current assets in excess of the debts becoming due and payable within one year, and H, total amount of assets after deduction of the debts becoming due and payable within one year.

The other items are the same as those provided for in the lay-out in Article 8.

Article 10

Where an asset or liability component pertains to several items, for example a claim arising under a sale to an associated undertaking, the reader of the balance sheet must be informed of it unless this is not essential to an understanding of the balance sheet.

Article 11

Reflecting as accurate a picture as possible of the company's position implies that the company must also disclose the commitments it has assumed

for account of third parties by furnishing guarantees of any kind. This concerns any commitments arising out of the issue or negotiation of bills of exchange, or by way of suretyship, guarantee or other similar security. If it is likely that such commitments will have to be honoured they must be shown under liabilities in the balance sheet (see also the principle set forth in Article 28(1) (b)).

SECTION 4

Special provisions relating to certain items in the balance sheet

Article 12

The classification of elements of assets under fixed assets or current assets depends on the purpose to which the company intends to put them. If they are to be used on a continuing basis to enable the company to operate they must be classified under fixed assets. If they do not satisfy this criterion they must be shown under current assets.

In accordance with paragraph 3, companies are obliged to show in the annual accounts the movements in the various items of fixed assets. The reader of the balance sheet will thus see how, by addition, disposal, transfer, upward revision or value adjustment, the fixed assets have reached the position shown at the date of the balance sheet. The upward revisions are corrections that have to be made after too great a value adjustment. To show these movements only the gross method is allowed. This consists in indicating the cumulative value adjustments up to the date of the balance sheet, starting with the initial purchase price or production cost. In certain Member States movements in fixed assets may also be shown by the net method, i.e. starting from residual values at the beginning of the accounting year only the value adjustments during the year are mentioned. The information on the development of the undertaking provided by this latter method is much more limited because the total amount of the value adjustments is not revealed. This is why the net method, which does not provide the same amount of information, has not been authorized.

The compulsory and exclusive application of the gross method might cause difficulty where on preparation of its annual accounts for the first time in accordance with this Directive the company does not know the initial purchase price or production cost of any of its fixed assets. In this case the company can start with the residual value at the beginning of the year and this value will continue to be the reference point for succeeding years (see par. 3(b)).

Under Articles 30 and 31 of this Directive the Member States may authorize certain departures from the standard valuation system based on purchase price or production cost. Here it is a question of valuation in accordance with the replacement value method of tangible fixed assets that are subject to depreciation (see Art. 30), or of the revaluation of tangible fixed assets or participating interests and other financial assets (see Art. 31).

Where any such exception is applied the presentation of movements in the fixed assets concerned will have to be adapted. In settling the rules relating to the adaptations required, the Directive had to deal with two points. First it was necessary to ensure that the gross method should also apply in the above-mentioned cases. To this end it is essential that the initial purchase price or production cost as well as the amount of the cumulative value adjustments at the balance sheet date be mentioned separately. Secondly it is considered essential that where exceptions are made the movements in fixed assets should be presented in such a way as to ensure comparability with the annual accounts in which the fixed assets have been valued in accordance with the standard valuation system based on purchase price or production cost. It is for this reason that on the one hand the amounts of the differences referred to in Article 30(2) and 31(2), i.e. the increases in value transferred to revaluation reserve as a result of valuation on the basis of replacement value or as a result of revaluation, and on the other hand the supplementary value adjustments, i.e. the additional value adjustments calculated on the basis of replacement value or of a revaluation, must be shown separately.

The gross method implies that not only the above-mentioned differences but also the supplementary value must be shown cumulatively. On the basis of all these different figures the reader of the balance sheet will be able to visualize the company's position in cases in which the valuation of the fixed assets concerned was made on the basis of the purchase price or production cost.

Movements in the various items of current assets must also be presented by use of the gross method. In certain Member States the value adjustments for current asset items are not shown separately. In such cases only the lowest value at the balance sheet date appears in the balance sheet. This does not provide the same amount of information as the gross method. What is more, it facilitates the formation of hidden reserves, to the extent that an under-valuation of elements of current assets is easier to effect if only the lowest value has to be shown, than if the initial value of the assets concerned has to be shown as well. The Directive accordingly requires the value adjustments effected in respect of current assets to be shown separately.

Under Article 30 the Member States may also authorize valuation of stock by the replacement value method. Here too, application of the gross method needs adaptation in the same way as for fixed assets. For this purpose the supplementary information required under paragraph 3 (c) for

fixed assets must be given here too. To avoid the situation where the inclusion of particulars of movements in fixed and current assets in the balance sheet makes comprehension of the balance sheet itself more difficult, such movements may be shown instead in the notes on the accounts.

Article 13

The fixtures and fittings, forming part of buildings, which must be shown under the item land and buildings are, for example, heating, lighting, air-conditioning systems, etc. Machinery and production equipment do not, however, form part of this item.

Article 14

Participating interests are defined by reference to a subjective test. For there to be a participating interest, the company's intention as to the use it will make of its rights in another undertaking is the determining factor. The holding of a specified percentage of the capital in another company is a less satisfactory test for, if the capital is widely dispersed, the holding of quite a small percentage of the capital might be sufficient to enable an influence over another undertaking to be exercised.

On the other hand, even where a majority of the shares is held, there may be no intention of establishing a lasting link with another undertaking, e.g. where the company purchases an undertaking having in its portfolio a block of shares that are not income-producing and that the company proposes to sell as quickly as possible. In such a case, the company should not be obliged to include the block of shares under participating interests and show it as such.

Article 15

Earnings relating to the year but which will not be received until later are to be shown under the item "Prepayments" on the assets side. They may also be shown however under debtors in accordance with the practice followed in certain Member States. Coordination on this point has not been considered necessary, as the amounts normally shown under this item are not very large. The same is true of "Accruals" shown under liabilities (see Art. 18). In this case the charges which, though relating to the year, will not be paid until a later year, may be shown either under "Accruals" or under creditors.

Article 16

The legal provisions or accounting practices in the different Member States regarding the ascertainment of reductions in the value of fixed assets or current assets sometimes lead to the use of concepts or nomenclature which at first sight are like those employed in other States, but which may relate to different phenomena.

In these circumstances the use in the Directive of any current nomenclature would have the disadvantage that it might easily have led to its being applied in ways that were not uniform. It therefore seemed best to disregard current terminology in referring to the phenomena in question, to establish the relevant principles by means of a community terminology and to specify comprehensively in the Articles concerned (33 and 36) the scope of the requirements and how they are to be applied.

Value adjustments differ from provisions for contingencies and charges (see Art. 17) in that they are adjustments made in respect of assets comprised in the balance sheet, whereas provisions for contingencies and charges do not relate to asset items but to future foreseeable losses or charges. In addition, provisions for contingencies and charges represent obligations and, therefore, outside funds, while value adjustments relate to the undertaking's own capital.

Article 17

By defining provisions for contingencies and charges strictly and precisely, the unwarranted inflation of these items and the formation of hidden reserves that could result from it should be avoided.

The expenses for which provisions may be made must be certain, and the kind of losses and charges that form the subject of provisions must be clearly defined. Furthermore, these expenses, losses or charges must have their origin in the year just closed or in a preceding year. In this way provisions clearly differ from reserves created to cover risks that are uncertain and general in nature.

Article 18

(See the notes on Art. 15.)

SECTION 5

Structure of the profit and loss account

Article 19

For presentation of the profit and loss account, the Member States must introduce into their law the four different lay-outs provided for in Articles 20 to 23. These lay-outs differ first as to their external form (horizontal or narrative) and secondly as to the method of treating and distributing charges and earnings. In the lay-outs given in Articles 20 and 21, there are on the one hand the total charges for the year classified according to their nature, and on the other hand the products sold (turnover), plus the production effected during the year but not yet sold, less the production sold during the year but produced in a previous year. In the lay-outs of Articles 22 and 23 the operating charges are classified essentially according to their function, and the charges corresponding to the production sold are shown opposite the amount of the turnover.

Freedom of choice between several lay-outs is necessary because from the business point of view the different principles governing the profit and loss account all have their advantages and disadvantages. Notwithstanding the various differences between them the solutions adopted are compatible with the objectives of Article 54(3) (g) of the EEC Treaty, for these systems, amplified by the particulars that have to be given in the notes on the accounts, produce the same result, and the information provided in relation to the most important items is the same.

The fundamental principles applicable to the establishment of the profit and loss account are respected in each of the lay-outs and this ensures equivalence between them. From the point of view of the management of the undertaking, one of the basic purposes of the profit and loss account is to show the source of earnings. This pre-supposes in particular the most rigorous application of the principle that items be shown gross, that is to say that the charges and earnings must not be offset; turnover in particular must be shown separately. To judge the results of an undertaking, it is also crucial to know to what extent the result shown is derived from what the undertaking has produced during the year, or from financial developments during the year, or indeed from exceptional operations unconnected with the undertaking's operations proper during the year. It is for this reason that the charges and earnings are uniformly split up into three corresponding groups of items.

In favour of the lay-out contained in Articles 20 and 21 it may be said first that the classification of charges according to kind does not pose any problem regarding the allocation of operating charges according to function, and secondly that it enables the value of the production of the undertaking to

be determined, which is a criterion of its profitability. The value of the production of an undertaking whose production can be stockpiled is made up of the amount of the product sold, and of that produced during the year but not yet sold. It must not be forgotten however that the total is made up of dissimilar components. The amount of turnover likewise includes the profit, while variations in the value of stocks of finished and semi-finished products are based on values to which the principle of the lowest value is applied. It is thus possible that over the years, profitability may show fictitious fluctuations by reason of variations in value of stocks of products not yet sold.

In favour of the lay-out contained in Articles 22 and 23 it may be said that the classification of operating charges according to function corresponds better in many cases to the methods of costing adopted by undertakings than a classification according to the nature of the costs, and thus gives an idea of the structure of the costs of the undertaking; in addition comparable elements are brought together. On the other hand it is not possible to determine the production actually achieved during the period under consideration, to the extent that this production is not entirely sold during the period; this entails, for instance when the period of manufacture is lengthy (as in ship-building), undesirable fluctuations in the result shown, if in such cases there are no intermediate accounts. In such a case as this it would be better, therefore, to choose the lay-out in Article 20.

Articles 20 and 21

The items "other operating earnings" and "other operating charges" shown in the lay-outs refer to operations that are not characteristic of the undertaking, but which arise with a certain degree of regularity (e.g. the earnings of a canteen). It is this which distinguishes them from exceptional earnings and exceptional charges, which while not being characteristic of the undertaking, are not regular in character either.

Under Article 5 the Member States may authorize adaptation of the lay-out of the profit and loss account in order to show the allocation of the results. This means that after the item Result for the year other items can be shown in the lay-out to indicate in what way and by drawing on which sources the allocation in question was arrived at.

Articles 22 and 23

See the notes on Articles 20 and 21.

Article 24

By virtue of this provision the Member States may authorize small companies to group certain items in the profit and loss account under the operating result, so that the net turnover figure will no longer be shown separately. This departure has been introduced to meet the keen anxiety that has been expressed that account should be taken of the special situation of companies whose activities are not, or are not to any extent, diversified.

The cumulative criteria adopted for the purpose of determining to which companies the foregoing applies are the balance sheet total, the net amount of turnover and the average number of employees during the year. These three criteria have been prescribed to take account of the different characteristics of trading companies, industrial companies and companies providing services. Often the first-named have a fairly low balance sheet total but a high turnover, while for the second the relationship is reversed; and the number of employees can be high in the case of service undertakings. Moreover, the position, from the legal point of view, of the assets employed and the degree of automation could also be decisive.

The balance sheet total results from the lay-out dealt with in Article 8. As the value adjustments can be shown equally well as items to be deducted on the assets side or as separate items on the liabilities side, it has been prescribed that if the second alternative is used they should be deducted from the balance sheet total.

In order to ensure some degree of continuity in the application of the rules in question, the last paragraph provides that if a company ceases to satisfy any one of the criteria, the obligation to publish the profit and loss account in full will continue until such time as none of the abovementioned limits is reached for two consecutive accounting periods.

SECTION 6

Special provisions relating to certain items in the profit and loss account

Article 25

The net turnover is of decisive importance for purposes of assessing the results of an undertaking. In fact, on the one hand price reductions on sales are not normally such as to affect seriously the gross amount of turnover, and on the other hand, as far as value-added tax and other taxes directly related to

turnover are concerned, the rates may vary according to product, and production exported is exempt.

Article 26

Exceptional earnings and charges must be mentioned separately so as to show the sources of the results for the year. Earnings attributable to another year, which must be shown under the item Exceptional earnings, may for example be taxes paid at too high a rate in some other year which have been refunded in the year under review. Exceptional earnings and charges differ from "other operating earnings" and "other operating charges" which appear in the lay-outs under operating results, in that they do not arise with any regularity (see the notes on Art. 20 and 21). To ensure that as accurate a picture as possible is presented of the results it has been prescribed that these products and charges must be mentioned in the notes on the accounts unless they are of no importance for an assessment of the results.

Article 27

Companies are also required to indicate the amount of the future liability to tax, that is to say tax in respect of which the fiscal liability arises during the course of the year, but for which payment will only be required in subsequent years. If for example fiscal law permits accelerated amortization, taxable profit is reduced accordingly but will increase inversely in subsequent years, since the asset will already have been written down in full.

SECTION 7

Valuation rules

Article 28

This Article sets out the most important general principles of valuation the application of which must be ensured by the Member States.

The principle of continuity already laid down in Article 3 as regards the structure of the annual accounts must also be applied to the valuation of the items (par. 1 (a)).

The principle laid down in paragraph 1 (b) is based on prudence and this principle of good commercial management is already applied in all the Member States. It is not dictated simply by the need to protect creditors: it is equally in the interests of the administration of the undertaking itself. This regard for prudence also finds expression in the principles set out in paragraph 1 (c) to (f) of this Article.

Nevertheless, for special, technical or business reasons these principles are not always applicable in practice. Consequently in certain cases a derogation from the principle of separate valuation is justified. It may be impossible or take too long to determine precise quantities or the real purchase price or production cost. For this reason methods have in practice been adopted which enable the quantities or prices to be fixed more readily e.g. valuation by categories or valuation at fixed values (cf. Art. 35). The application of such methods gives no ground for objection if it produces results that do not differ fundamentally from those produced by separate valuation. Departure from the general principles is allowed provided it is declared and justified in the notes on the accounts. This implies that where those principles have been departed from, the effect on the picture given of the company's assets, financial position and results will be indicated (par. 2).

Articles 29 and 30

Valuation in the annual accounts can at present be effected in principle by two methods: the purchase price method and the replacement value method.

In favour of the use of the purchase price method it can basically be said that the historical value can be ascertained precisely, whereas values that are determined by taking account of fluctuations in the value of money or changes in replacement prices due to any other causes are difficult to calculate accurately. Even if the annual profit calculated on a purchase price basis may include adventitious amounts, this profit need not necessarily be distributed. On the contrary, it is open to the company's administrative organs when they decide on the allocation of the profit to apply the principle of conservation of the capital in real terms or of maintenance of the company's substance by appropriating the necessary amounts to a reserve opened for that purpose.

On the other hand, it can be argued in favour of a method of valuation that takes account of the fluctuations in the value of money or changes in replacement prices due to other causes, that the annual profit can be calculated more accurately. This method makes it possible to apply the principle of conservation of the capital in real terms or of maintenance of the company's substance when the profit is being calculated, and so makes it possible to determine more accurately what charges are required for this purpose. At all

events, a wide margin of discretion is left in this case to the administration of the undertaking as regards the calculation of values, as the criteria in this field are less precise than those for ascertaining purchase prices or production costs.

In accordance with the existing regulations and the practice obtaining so far in the majority of the Member States, the provisions of the Directive are based on the purchase price or production cost principle, the essential rules for the application of which are contained in Articles 32 to 39. However, to take account also of the practice in one of the Member States and so as not to prevent the development and adaptation of the rules of valuation for the purpose of taking into consideration fluctuations in the value of money or changes in replacement prices due to any other causes, an exception in respect of the requirements of Articles 32 to 39, which allows the Member States to provide for valuation on a replacement value basis, has been introduced in Article 30. In addition, Article 31 authorizes the Member States under certain conditions to permit revaluation, which also constitutes a derogation from the purchase price or production cost principle.

The Directive makes no detailed regulations concerning valuation at replacement value. The discussions regarding this method are still far from complete. For this reason it scarcely seems possible, nor for that matter desirable, to frame precise provisions on this point, which would prevent future developments in this field from being taken into account. For the rest, undertakings must always, even when they apply the replacement value principle, be guided by the imperative requirement contained in Article 2, namely to reflect the company's position as accurately as possible. In this connection the inspection by the auditors must not be overlooked.

Use of the replacement value method has been confined to tangible fixed assets that are subject to depreciation and to stocks. In fact it is these elements that are utilized in the production cycle and must consequently be replaced regularly. The application of this method to intangible fixed assets would not produce sufficiently reliable valuations. Accordingly it has not been authorized.

Valuation by the replacement value method as provided for in Article 30 implies that the asset elements concerned are shown in the balance sheet at their replacement value. In consequence a revaluation of these items has to be made in the balance sheet. In this way both the picture presented of the results and that presented of the assets will be based on the same parameter. The amount of the revaluation must be shown in the revaluation reserve.

The presentation of the movements in the relevant elements prescribed by Article 12 must be supplemented in cases where the replacement value method is used. For this purpose the amount of the revaluations and of the additional value adjustments, must be shown separately on a cumulative basis in each case.

These particulars are of vital importance in the system adopted by the Directive for they ensure that the information provided is comparable to that given where the classical valuation system based on the purchase price or production cost is used. Consequently there is no need for apprehension that the use of these two quite different methods of valuation may destroy the comparability of annual accounts in the Community.

The companies must draw attention in the notes on the accounts to the use made of the replacement value method and indicate the items concerned. The notes on the accounts must indicate in particular the basis on which the replacement value has been calculated.

The revaluation reserve is necessarily a tied reserve. This follows directly from the thinking behind the replacement value method. In fact the amounts allocated to it are for the purpose of maintaining the potential of the undertaking. Any distribution of profits out of that reserve or writing off of losses against that reserve is thus excluded on principle. This could only be permitted to the extent that the amounts allocated to the revaluation reserve are no longer needed for replacement of the asset elements concerned. Such would be the case if replacement values declined or if the undertaking were to reduce its productive activities, e.g. by selling a branch of its production undertaking. The corresponding amounts in the revaluation reserve would no longer be necessary in that case for maintaining the productive capacity of the undertaking, but they would then have to be added to the result for the year, failing which the company would hold these sums in reserve and would thereby be in breach of the compulsory rules relating to the allocation of the result. This is why reduction of the revaluation reserve is made compulsory in these cases (par. 4 and 5).

The tied character of the revaluation reserve does not preclude capitalization thereof in full or in part, as indeed is normal practice in the Member States. Of course, if this happens the amounts involved remain available to the undertaking (par. 3).

Although there may have been an increase in replacement value paragraph 6 prohibits any revision of the value adjustments made during previous years at rates that were too low.

Article 31

The Member States may authorize further departure from the purchase price or production cost principle by allowing revaluation of the tangible fixed assets, participating interests and other financial assets. Valuation by the replacement value method is not allowed in the majority of Member States, but most of them do allow revaluation, especially as regards land and

participating interests. The aim is to give the reader of the balance sheet a more accurate picture of the economic value of the asset concerned at the date of the balance sheet.

The current assets are not to be revalued. The need for revaluation of these items will scarcely arise, for they will not remain long in the undertaking.

In the event of revaluation also, comparability with the annual accounts in which the purchase price principle has been strictly applied must be ensured. On this point the same observations may be made as appear above in relation to use of the replacement value method (see also the notes on Art. 12).

Increases in value arising on revaluation must be shown in the revaluation reserve. The reserve must be maintained until such time as the increases in value recorded therein have actually been realized. Once this condition is satisfied, the reserve must be written back. The amounts concerned must be added to the result for the year so that the company's organs responsible for deciding on the allocation of the results may take their decision.

For the reasons set out above in the notes on Article 30, there is nothing to prevent the revaluation reserve from being capitalized in whole or in part.

In framing the rules relating to revaluation, the Directive has disregarded any revaluations that may be authorized by the laws of the Member States to take account of depreciation in the value of money.

Article 32

As regards entry on the assets side of the balance sheet and valuation of the formation expenses, the practice adopted in the various Member States is not the same. In certain Member States these expenses are written off immediately and showing them as assets is either prohibited by law or occurs only very rarely in practice. In other Member States on the contrary these expenses may be shown as assets, but if so then either they must be written off as quickly as possible or any distribution of profits is prohibited until they have been completely written off.

The Directive does not prohibit formation expenses from being included under assets. The Member States are left free as to this. Inclusion thereunder is considered permissible for the reason that writing them off completely in one year could detract from the accuracy of the picture of the company's results. Where the national law authorizes them to be included under assets these expenses must be shown in a special item in the balance sheet (Art. 8 and 9, under B). In addition they must be written off over a period of not

more than five years. No distribution of profits may be made until these expenses have been completely written off, unless the company has optional reserves of an amount at least equal to the amount of the expenses not written off. These particularly strict valuation rules may be justified by the fact that it will often be very difficult to assess how useful the incurring of these expenses was to the company and, consequently, what worth they have.

The Directive does not define formation expenses. The various national definitions thus continue to apply. Coordination in this matter has not been considered necessary since, first, the amounts usually shown in these items are small and, secondly, the valuation rules laid down are strict. Moreover the make-up of this item will be shown in the notes on the accounts.

Article 33

This Article sets out the rules for the valuation of fixed assets. The value of fixed asset items with a limited useful life must be reduced by value adjustments calculated in accordance with the dictates of good management. This requirement is considered to be satisfied by all value adjustments that result in a judicious, not arbitrary, distribution of the purchase price or production cost over the period of utilization. In addition, whether or not their use is limited in time, the fixed assets must be the subject of value adjustments so that these items are taken at the lowest value attributable to them at the balance sheet date. These value adjustments are compulsory where the depreciation in value is expected to be permanent [par. 1 (c) under (bb)]. Contrary to the provisions regarding current assets, it is not in fact necessary to take account of short-term fluctuations in value in the case of fixed assets, which by definition are intended for permanent use in the operations of the undertaking.

To avoid the formation of hidden reserves it is prescribed that if the showing of items at their lowest value is no longer justified, they must be shown at their higher value [see par. 1 (c) under (dd)].

In certain Member States fiscal law has an important influence on the commercial balance sheet. Particular valuations authorized by fiscal law are accepted by the fiscal authorities only if the company uses those valuations in its commercial balance sheet as well. For this reason, and in order to ensure the comparability of annual accounts, it has been laid down that any exceptional value adjustments that have been effected by virtue of fiscal law must be shown separately in the notes on the accounts [par. 1 (d)].

Incidental expenses must be included in the purchase price; this appears necessary in order to limit the formation of hidden reserves (par. 2).

As regards the inclusion of a proportion of the indirect production costs in the production cost, the decision should be left to the undertaking, which may thus, in the context of part cost calculation, already frequently practised, decide—in particular so as to arrive at a prudent valuation—not to include a proportion of the indirect production costs (par. 3).

The Member States may permit interest on borrowed capital to be included in the production cost. This is only allowed to the extent that the interest forms part of the operating and administrative expenses [par. 4 (a)]. The Member States may also allow interest on own capital to be included in the production cost provided the amount involved is shown in the notes on the accounts [par. 4 (b)]. This requirement appears necessary for administrative reasons, so that in particular cases the picture presented of the position of the undertaking is not distorted (e.g. in the case of housing construction companies which finance the construction of their buildings by means of their own capital).

Article 34

For inclusion under assets in the balance sheet and valuation of the cost of research and development the same rules apply as are laid down in Article 32 in respect of formation expenses. On this subject similar comments to those contained in the notes on Article 32 may be made. Where national law authorizes them to be included under assets, these expenses must be shown in the items provided for that purpose in the balance sheet (see Art. 8 and 9, under C I 1).

The goodwill shown in the balance sheet must in principle be written off over a period of not more than five years. This rule does not exist at present in all the Member States; in one Member State this item is never written off, while in another Member State goodwill is written off immediately. The solution adopted is necessary, however, from the point of view of coordination, to ensure a degree of uniformity in the accounting treatment of this item. On the other hand it has not been considered necessary to prohibit any distribution of profits until this item has been completely written off, in contrast to the provisions relating to formation expenses and cost of research, since these cases involve values in respect of which expenditure has been incurred.

Article 35

The simplified method of valuation authorized in this Article for tangible fixed assets, together with raw and auxiliary materials, is recognized in the majority of Member States. This method constitutes an exception to

the rule of separate valuation laid down in Article 28(1) (e). For this reason the use of this method has been confined to cases in which the total value of the items involved is of secondary importance to the undertaking (e.g. repair equipment, tools, etc.).

Article 36

The current assets, being intended for circulating use, must be valued according to the principle of lowest value. The lowest value is arrived at by comparing the purchase price or production cost with the actual value attributable to the items at the balance sheet date. In most cases the lowest value which must be shown in the balance sheet by means of value adjustments will be the daily price or the market price. If these cannot be established, as for example in the case of semi-finished products, work involving the making up of goods from materials supplied, and creditors, the main criterion for determining the value at the balance sheet date will be the sale value at that date.

The authorization contained in paragraph 1 (c) to make exceptional value adjustments to take account of probable reductions in value in the near future must be interpreted most conservatively. The authorization is in fact intended to apply to particular goods such as non-ferrous metals, the value of which is subject to sizable fluctuations. As the value of these goods at the balance sheet date may be arbitrary, the rule of prudence militates in favour of taking account of later falls in value.

As regards paragraphs 1 (d) and (e) and paragraph 2, reference may be made to the notes on Article 33.

Article 37

This Article does not authorize a different valuation method from that laid down in Article 36. It permits merely a simplified method of calculating the purchase price or production cost by reference to price variations for similar items of stock. Such methods are known in all the Member States.

Article 38

The situation referred to will arise for the most part upon the issue of bonds below par. However, the possibility is not excluded that other long-term debts may entail payment of part of the interest *non pro rata temporis*. In such cases the amounts involved relate to several years. This justifies their inclusion under assets.

The Member States may themselves determine under what balance sheet item on the assets side the amounts involved should be shown. In certain Member States they are shown under formation expenses, in others they appear under "Prepayments". Coordination in this matter is not essential, as the amounts must in any case be mentioned separately either in the balance sheet or in the notes on the accounts.

Article 39

The formation of hidden reserves under the item provisions for contingencies and charges is prohibited. On the other hand undertakings are obliged to make provision for all contingencies that can be foreseen at the balance sheet date [Art. 28(1) (b)]. In order to avoid any abuse, it has been laid down that the provisions that appear in the balance sheet under the item Other Provisions should be specified in the notes on the accounts where they are of any importance.

SECTION 8

The Notes on the Accounts

Articles 40, 41 and 42

With a view to achieving the purpose specified in Article 2(3), the notes on the accounts explain the various items in the balance sheet and the profit and loss account (Art. 40).

Article 41 sets forth the minimum particulars that the notes on the accounts should contain. Other information should be given there in pursuance of Articles 3, 4(2), 10(1), 11, 12(3) and (4), 26(2), 28(2), 30(1), 31(1), 32(2), 33(1) (c) (cc) and (d) and (4), 34, 36(1) (c) and (e), 38(1), 39 and 42.

It is very important in the first place that companies should indicate the methods of valuation, including those used in calculating the value adjustments, applied to the various items in the annual accounts [Art. 41(1)]. The indication might relate for example to the application of Article 35, any exceptional value adjustments made under Article 36(1) (c), or calculation of the purchase price or production cost of stocks in accordance with one of the methods authorized by Article 37. Where valuation has been made on the basis of replacement value or revaluation, Articles 30(1) and 31 already require an appropriate indication to be given. If a company changes its

methods of valuation in any way it must mention the fact separately in the notes on the accounts and give the reasons therefor in accordance with Article 28(2).

The notes on the accounts must show the name and head office address of the undertakings in which the company holds not less than 10% of the capital, together with the proportion of the capital held, the amount of the subscribed capital, the reserves and the results for the last business year of the undertakings in question [Art. 41(2)]. This obligation is thus not confined to undertakings in which the company has a participating interest within the meaning of Article 14. These particulars, are necessary to enable the reader of the balance sheet to obtain a better picture of the value of these asset items. A mere statement of the purchase price of shares often gives an incorrect picture of the position of the undertaking concerned.

In order to avoid overloading the notes on the accounts with the particulars required by Article 41(2), the Member States may under Article 42 require the particulars to take the form of a summary deposited in accordance with Article 3(1) and (2) of Directive No. 68/151/EEC of 9 March 1968. If this is done the fact must be mentioned in the notes on the accounts. Finally, the Member States may authorize the omission of these particulars where, in the opinion of a reasonable business man, they would be seriously prejudicial to any of the undertakings concerned, but the omission must be mentioned in the notes on the accounts [Art. 42 (b)].

It has been thought desirable that for the information of shareholders the use made of any approved capital should be mentioned in the notes on the accounts [Art. 41(3)]. Attention is drawn to the fact that Article 2(1) (e) of Directive No. 68/151/EEC of 9 March 1968 requires publication annually of the amount of the subscribed capital where the instrument of constitution or the statutes mention approved capital.

Shareholders and third parties have an interest in knowing of the existence of any entitlement on the part of any persons to share in the profits, of any convertible debentures or similar securities or rights [Art. 41(4)], because their existence may influence considerably the life of the company. "Similar rights" include, inter alia, schemes for the purchase of shares by executives and personnel of the company.

The notes on the accounts must also indicate the total amount of the financial commitments that are not shown in the balance sheet, in so far as this is of assistance in assessing the financial position [Art. 41(5)]. This refers to commitments which are not in the nature of provisions nor of debts. They might for example include obligations in respect of leasing contracts, and long-term contracts for the chartering of ships or renting of buildings, etc.

Personnel costs are required to be shown in the notes on the accounts only in cases where the profit and loss account is based on the lay-outs

contained in Articles 22 or 23 in which these costs are not shown separately [Art. 41(6)].

Taxes included in the operating results, financial results or exceptional results must be shown separately for each of the results [Art. 41(7)].

The fiscal advantages granted to undertakings are very different from one Member State to another. To the extent that the annual accounts are affected thereby it is very important, for the purpose of obtaining comparable accounts, that the amount of the change in the results for the year as a result of the application of fiscal law should be shown in the notes on the accounts [Art. 41(8)].

An indication of the amount of the emoluments granted during the year to the members of the administrative, managerial and supervisory bodies by reason of their responsibilities, showing the total for each category, is of particular importance to the shareholders [Art. 41(9)].

Finally, both shareholders and third parties are interested in knowing to what extent advances or credits have been granted to members of the said bodies and to what extent the company has assumed liabilities on their account by way of guarantees of any kind [Art. 41(10)]. It goes without saying that the obligation to supply this information does not concern the Member States in which such operations in favour of members of the organs of the company are prohibited by law.

SECTION 9

Contents of the Annual Report

Article 43

The annual report must set out all the facts that do not directly relate to the various items in the annual accounts but do affect the overall appreciation of the economic position of the company. In this report the organs of the company express their personal opinions on the development and future prospects of the company.

The distinction made in the Directive between the notes on the accounts and the annual report is not made in all the Member States. There is no objection to the information to be given in the notes on the accounts and in the annual report being contained in a single document provided it includes all the particulars required by the Directive. However, it should be pointed out that under Article 44(2) the notes on the accounts, which form part of the

annual accounts, must be published in full in a national gazette whereas for the annual report publication of a note in a national gazette to the effect that it has been deposited, is sufficient [see Art. 44(3)]. It is clear that if a single document is prepared, it is the requirements relating to publication of the notes on the accounts that must be observed.

SECTION 10

Publication

Article 44

The annual accounts, that is to say the balance sheet, the profit and loss account and the notes on the accounts, after approval by the competent organs of the company, together with the annual report and the report prepared by the person responsible for auditing the accounts, must be lodged without delay in accordance with the rules laid down in Article 3(1) and (2) of Directive No. 68/151/EEC of 9 March 1968. Thereafter both the annual accounts and the auditor's report must be published in full in a national gazette. As far as the annual accounts are concerned this requirement is by way of exception to Article 3(4) of the said Directive whereunder it is sufficient that there be publication in a national gazette of an extract or of a note indicating that they have been deposited. By insisting on stricter publication this Directive aims to make the annual accounts more readily available to third parties, among whom are included future shareholders of the company.

Articles 45 and 46

These rules are designed to prevent any abuse in connection with publication of the annual accounts and report. At the time of any publication in full of these documents, otherwise than as provided in Article 44, they must be reproduced in the form and text on the basis of which the person responsible for auditing the accounts drew up his report, and they must be accompanied by the full text of the auditor's certificate. In the cases referred to in Article 45 full publication of the auditor's report does not seem to be essential, and it will be enough if the annual accounts are accompanied by the auditor's certificate. If the auditor has qualified his certificate or has refused to issue a certificate, this must be pointed out and the reasons for it must be given.

In case of abridged publication of the annual accounts, e.g. for publicity purposes, its incomplete character must be indicated and reference must be made to the national gazette in which full publication was made. To avoid any misunderstanding it has been laid down that the auditor's certificate is not to be included in this type of publication. Nevertheless it must be stated whether the certificate was given with or without qualification or whether it was refused.

Article 47

See the notes on Article 5.

SECTION 11

Special provisions relating to the société à responsabilité limitée, the Gesellschaft mit beschränkter Haftung, the Società a responsabilità limitata and the vennootschap met beperkte aansprakelijkheid

Publication of the annual accounts of these companies is not strictly necessary for the information of members. Shareholders in a société anonyme, Aktiengesellschaft, Società per azioni or naamloze vennootschap cannot normally be kept informed otherwise than by publication of the accounts. The members of an SARL, GmbH, sarl or Vmba on the other hand are known to the company and can be informed individually by it. Consequently in the case of the latter companies a distinction may be made between internal information for the benefit of the members and external information for the benefit of third parties, including creditors.

As far as the internal information is concerned, the rules laid down for the SA, AG, SpA and NV can without difficulty be declared applicable to the SARL, GmbH, sarl and Vmba. To obtain as accurate a picture as possible of the company's position the members of these latter companies must be treated in the same way as shareholders of the former.

As regards external information the position is more complicated. As this information only concerns third parties, is full publication of the annual accounts called for in all cases? In the Member States the answers given to this question are very different. In certain Member States it is considered that any limitation of liability should necessarily be accompanied by widespread information to the public to protect the interests of creditors and other third parties, so that as far as disclosure is concerned no distinction is made between the SA, AG, SpA or NV and the SARL, GmbH, sarl or Vmba. In other Member States on the other hand the extent of the publicity required of the

latter companies is geared to the importance of these companies. For the large ones wide publicity is considered necessary in view of their importance to the national economy. For the smaller ones Parliaments have considered that a conflict arises between the interest that these companies may have in not publishing their annual accounts and the interest of third parties, which demands precisely such publication. These Member States have resolved this conflict of interest in favour of the companies by not insisting on any disclosure from them.

Directive No. 68/151/EEC of 9 March 1968 has already established the requirement of disclosure of the annual accounts of the SARL, GmbH, sarl and Vmba. Compulsory implementation thereof has been deferred until the date of entry into force of this Directive, which is to govern both the content and the extent of this disclosure [Art. 2(1) (f)].

The decisive argument in favour of the necessity to publish the accounts of these companies stems from the privilege that they enjoy as regards limited liability. The rights of creditors are limited to the assets of the company. It is therefore essential that they should be put in a position by some degree of disclosure of the annual accounts to assess the asset position. Otherwise all justification for the limitation of liability disappears. The limitation of liability which is an advantage to the members on the one hand and a disadvantage to the creditors on the other hand must necessarily be accompanied by some degree of disclosure of the annual accounts.

It must also be borne in mind that undertakings in certain Member States choose to operate in the form of an SARL, GmbH, sarl or Vmba, whereas in other Member States it would be more usual for them to operate in the form of an SA, AG, SpA or NV. Inasmuch as these undertakings compete with one another, the interests of establishing competition free from distortion in the Common Market make it necessary that as regards disclosure the two forms of company should be subject so far as possible to the same requirements.

Finally, the disclosure provided for is designed to satisfy a general economic need. This need arises from the fact that an increasingly important part of industry in the Community has been organized in the legal form of the SARL, GmbH, sarl or Vmba.

This Directive does not prescribe uniform disclosure for all such companies. The extent of the disclosure has been tied to the size of the company in accordance with the decisions of the Council in Directive No. 68/151/EEC of 9 March 1968. The greater the importance of the company to the national economy and to the Common Market, the greater the importance of disclosure. Three categories have been drawn. The companies in the first category must be subject to the same publicity requirements as the SA, AG, SpA and NV. So far as the companies in the second category are

concerned, the Member States retain the same powers of exemption as are laid down in Article 24 in respect of the SA, AG, SpA and NV of comparable size, that is to say that the profit and loss account need not compulsorily show the net turnover separately where the national Parliament considers it proper to grant exemption from that requirement. As regards the companies in the third category, the Member States must have power to exempt them from the requirement of publication of the profit and loss account.

The solutions adopted may be summarized as in the following table:

Categories	Balance sheet total in units of account	Net turnover in units of account	Average number of employees over the year	Disclosure required
I. (See Art. 50, § 1).	Exceeding 1 million.	Exceeding 2 million.	Exceeding 100.	Annual accounts, annual report, auditor's report.
II. (See Art. 50, § 2a).	From 100 001 to 1 million	From 200 001 to 2 million.	From 21 to 100.	As for I.; the national law may provide that the profit and loss account need not compulsorily show the net turnover separately.
III. (See Art. 50, § 2b).	Up to 100 000	Up to 200 000	Up to 20	As for I.; the national law may provide that publication of an abridged balance sheet and abridged notes on the accounts is sufficient.

Transfer to the second or to the first category takes place when any one of the conditions applicable to these categories is satisfied.

It should be pointed out that the figures adopted for purposes of classification in the first category have been selected from the 1964 Commission proposal for a first Directive on the basis of Article 54(3) (g) of the EEC Treaty (supplement to EEC bulletin No. 3-1964, page 13 et seq.). Under Article 2(6) of that proposal each SARL, GmbH, Sarl and Vmba whose balance sheet total exceeds 1 million units of account would have to publish its balance sheet and profit and loss account.

Article 48

The annual accounts and report submitted to members—as a matter of internal information, therefore—must be drawn up in accordance with the

rules laid down in the Directive in respect of the SA, AG, SpA and NV. There is, of course, no reason for treating the members differently from shareholders in those companies.

One of the characteristics of the SARL, GmbH, sarl or Vmba is that it may have claims on and debts payable to its members which could be of considerable importance to the company's position. The Directive takes account of this by providing that these items must be shown separately. Moreover the wording of the items shown in the lay-out must be adapted to suit the legal form of these companies.

Article 49

To ensure that the information contained in the annual accounts and report is reliable these documents must be audited by an independent expert. On this matter, no distinction of principle can be made between the SA, AG, SpA or NV and the SARL, GmbH, sarl or Vmba. Compulsory audit of the accounts of these latter companies by the persons authorized under national law to audit the accounts of the former should therefore be required.

However, in view of the situation that exists in the Community a more pragmatic approach seems to be called for. A large number of companies in the form of the SARL, GmbH, sarl or Vmba already have their accounts audited voluntarily, often by persons who do not satisfy the requirements laid down by law for the auditing of the accounts of the SA, AG, SpA or NV. In these circumstances the Directive confines itself to making audit compulsory and leaves the Member States to organize it in the most suitable way.

Compulsory audit of the very large number of companies in the form of the SARL, GmbH, sarl or Vmba falling within the third category might prove to be impossible in practice, the professional bodies of auditors of accounts in the various Member States having too few members to carry out the audits. Furthermore, such audits could prove too burdensome for the companies concerned. For these reasons the companies possessing the characteristics set out in paragraph 2 can be exempted from compulsory audit. In these circumstances appropriate penalties must be introduced into the national laws to ensure that these companies observe the rules laid down in this Directive. As to the criteria used for defining these companies, reference should be made to the notes on Article 24.

Article 50

In principle every SARL, GmbH, sarl and Vmba should publish its annual accounts and report together with the report drawn up by the person responsible for auditing the accounts, in the manner prescribed in the case of

the SA, AG, SpA and NV (Art. 44). It should also publish the proposed allocation of the results and the actual allocation itself (see Art. 47). The Member States may, however, prescribe a lesser degree of disclosure for companies in the second and third categories.

The Member States may authorize companies in the second category to publish the profit and loss account in the abridged form provided for in Article 24 in respect of certain companies that exist in the form of SA, AG, SpA or NV, i.e. without showing net turnover separately. So far as the presentation of the accounts is concerned, this is the only exception applicable to companies in the second category; otherwise they must publish their annual accounts and report and the auditor's report containing the same material as in the case of the SA, AG, SpA and NV. On the other hand, as regards the form which disclosure must take, full publication of the accounts in a national gazette, as required for the SA, AG, SpA and NV, does not seem necessary in the case of these companies. Accordingly the Member States may allow them to publish the documents in question in accordance with the normal rules relating to disclosure as laid down in Article 3 of Directive No. 68/151/EEC of 9 March 1968 [par. 2 (c)]. Publication of an extract or of a note in a national gazette mentioning the fact that the documents have been deposited will then suffice.

The Member States may authorize the SARL, GmbH, sarl and Vmba in the third category—as defined in Article 49(2)—to publish only a balance sheet and notes. These companies may then be exempted from disclosing the profit and loss account and annual report. In addition the balance sheet and notes to be published may be abridged. The balance sheet need only include the items that are preceded by letters and Roman numerals shown in the lay-outs in Articles 8 and 9. It will then be sufficient to indicate the main items without subdivisions, as for example “Intangible Assets”, “Tangible Assets”, etc. Nevertheless, claims on and debts to members must be shown separately in this balance sheet, as these items can be of great importance for forming an assessment of the position of the company. To allow for this abridged presentation of the balance sheet, the notes may also be adapted.

The companies in this third category are not exempt from the obligation to show the movements in fixed assets and in current assets (see Art. 12), but it will be enough if they show the total amounts for the different groups of assets.

As in the case of those in the second category, full publication of the balance sheet and notes in a national gazette has not been considered necessary for companies falling within the third category. Normal disclosure as required under Article 3 of Directive No. 68/151/EEC of 9 March 1968 is sufficient in the case of these companies [par. 2 (c)].

Every SARL, GmbH, sarl and Vmba without exception must publish the allocation of its results.

SECTION 12

Final provisions

Article 51

The Directive allows the Member States a period of 18 months in which to make the necessary amendments to their laws. In addition a further period of 12 months is allowed for bringing these amendments into force. In this way companies may be given an opportunity to adapt if necessary, the organization of their accounting system and generally to prepare themselves to provide the information required by this Directive.

In the lay-outs of the balance sheet and profit and loss account some items appear which relate to associated undertakings. In other Articles of this Directive these undertakings have also been mentioned. The Directive does not, however, define these undertakings. A definition is to be given in a subsequent Directive relating to consolidated accounts which is now in course of preparation. For this reason it has been provided that the obligation to give the particulars required in respect of associated undertakings will enter into force at the same time as the Directive abovementioned (par. 2).