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Proposal for a seventh Directive pursuant to Article 54 (3) (g) of the EEC Treaty concerning group accounts

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Commission of the
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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 Commitee;

Whereas Directive No .... of the ....[1] for coordination of national legislation regarding the annual accounts of limited liability companies applies to the accounts of individual companies; whereas at present a growing number of companies are no longer managed independently but belong to groups in which management of the undertakings belonging to the group is coordinated in the interests of the whole group; whereas the annual accounts of companies belonging to a group cannot by themselves give a true and fair view of their position; whereas group accounts should therefore be drawn up in order to give a true and fair view of the economic unit constituted by the group and whereby the position of a company belonging to the group can be determined more easily; whereas coordination of national laws on group accounts is therefore essential in order to complete the scope of the Directive referred to above and to attain the objective that information required to be published by companies within the Community to protect the interests of their members, their employees and third parties be drawn up on equivalent lines and may be duly compared;

Whereas groups of companies are in fact economic units in which all the member companies and undertakings are managed on a central and unified basis in the interest of the whole group; whereas this central and unified management within a group is normally exercised as a result of the relationships of dependence linking group undertakings; whereas, however, a group sometimes consists of undertakings which exist on an equal footing with one another; whereas a definition of groups must be given which takes account of these economic characteristics;

Whereas the purpose of coordinating laws on group accounts is to protect all the interests subsiting in limited liability companies; whereas in order to provide such protection, it must become compulsory to draw up group accounts both in respect of companies heading a group and those which are in a position of dependency within a group; whereas in order that the information given is complete, it is also necessary that, when a group is organized with several levels, special consolidated accounts be drawn up for the different part of the group (sub-group accounts);

Whereas group accounts should give a true and fair view of the assets, liabilities financial position and results of the group; whereas the annual accounts of all the undertakings belonging to a group should in principle therefore be required to be consolidated; whereas when the accounts are consolidated, the relevant items in the annual accounts of group undertakings should be incorporated in full in the group accounts, with interests held by persons outside the group being shown separately; whereas, however, the necessary corrections should be made in order to eliminate any transactions or financial relationships between group undertakings;

Whereas a number of general principles relating to the drawing up of group accounts and the valuation of items in those accounts must be laid down in order to ensure that items are presented coherently and can be readily compared both as regards the methods used to value them and the periods covered by the accounts;

Whereas holdings in the capital of undertakings over which group undertakings exert a significant influence without however controlling such undertakings should also be valued realistically in the group accounts by taking account of the results obtained by the relevant undertakings;

Wheras it is of vital importance for all those having an interest in a company belonging to a group that information on the structure of groups should be published; whereas it is therefore essential that the notes to the group accounts should contain precise information on the undertakings belonging to the group and the nature of the legal relationship connecting them to the group,

Has adopted this Directive:

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[1] Amended proposal for a fourth Directive regarding the annual accounts of limited liability companies, Supplement 6/74 — Bull. EC.

Section 1

Definitions

Article 1

1. For the purposes of this Directive, an associated undertaking means an undertaking over which another undertaking exercises, directly or indirectly, a significant influence.

2. An undertaking is presumed to be associated with another undertaking where the latter undertaking holds, directly or indirectly, 20 % or more of the capital of the former undertaking or of the votes attaching to shares issued by that undertaking.

3. For purposes of application of paragraphs 1 and 2, holdings of a dependent undertaking within the meaning of Article 2 of the Directive, and holdings of a person acting on behalf of the undertaking or of an undertaking dependent on it shall be regarded as forming part of the holding of one undertaking in the capital of another.

Article 2

1. For the purposes of this Directive, a dependent undertaking means an undertaking over which another undertaking, referred to as the dominant undertaking, is able, directly or indirectly, to exercise a dominant influence.

2. An undertaking is presumed to be dependent on another undertaking where the latter undertaking, directly or indirectly:

(a) holds the major part of the undertaking's subscribed capital; or

(b) controls the majority of the votes attaching to shares issued by the undertaking; or

(c) can appoint more than half of the members of the undertaking's administrative, managerial or supervisory body.

3. Holdings of an undertaking dependent on the dominant undertaking and holdings of another person acting on behalf of the dominant undertaking or of an undertaking dependent on it shall be regarded as forming part of the holding of the dominant undertaking.

Article 3

1. For the purposes of this Directive, a dominant undertaking and one or more undertakings dependent on it shall constitute a group if the dominant undertaking exercises in practice its dominant influence to the effect that all such undertakings are managed on a central and unified basis by the dominant undertaking. Each such undertaking is a group undertaking.

2. Where an undertaking is dependent on another undertaking as defined in Article 2 of this Directive, the dominant undertaking and the dependent undertaking are presumed to constitute a group.

Article 4

1. Undertakings between which no relationship of dependency as defined in Article 2 exists shall also be regarded as constituting a group for the purposes of this Directive if all such undertakings are managed on a central and unified basis. Each such undertaking is a group undertaking.

2. Where in a group as defined in paragraph 1, one or more group undertakings exercise in practice a dominant influence on one or more other undertakings to the effect that all such undertakings are managed on a central and unified basis, those dependent undertakings shall also form part of the group and each of them is a group undertaking.

Article 5

For the purposes of Directive No ....[1] of .... and of this Directive, the following are affiliated undertakings:

(a) undertakings between which a relationship exists as defined by Article 1 of this Directive;

(b) dominant and dependent undertakings within the meaning of Article 2 of this Directive;

(c) undertakings forming part of a group within the meaning of Articles 3 and 4 of this Directive.

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[1] Amended proposed for a fourth Directive on annual accounts, Supplement 6/74 — Bull. EC.

Section 2

Scope

Article 6

1. (a) Where a dominant undertaking of a group has its registered office within the Community, it shall draw up group accounts and a group annual report if either the dominant undertaking of the group or any dependent group undertaking is established as one of the following types of company:

— in Germany:
die Aktiengesellschaft, die Kommanditgesellschaft auf Aktien, die Gesellschaft mit beschränkter Haftung;

— in Belgium:
la société anonyme, de naamloze vennootschap, la société en commandite par actions, de commanditaire vennootschap op aandelen,
la société de personnes à responsabilité limitée, de personenvennootschap met beperkte aansprakelijkheid;

— in Denmark:
Aktieselskab, Kommandit-Aktieselskab, Anpartsselskab;

— in France:
la société anonyme, la société en commandite par actions,
la société à responsabilité limitée;

— in Ireland:
companies incorporated with limited liability;

— in Italy:
la società per azioni, la società in accomandita per azioni,
la società a responsabilità limitata;

— in Luxembourg:
la société anonyme, la société en commandite par actions,
la société à responsabilité limitée;

— in The Netherlands:
de naamloze vennootschap, de besloten vennootschap met beperkte aansprakelijkheid;

— in the United Kingdom:
companies incorporated with limited liability.

(b) Without prejudice to the provisions of Article 10, the annual accounts of all undertakings forming part of the group, without regard to where their registered offices are situated, shall be consolidated. The group accounts shall be drawn up as of the same date as the annual accounts of the dominant group undertaking.

2. (a) Each dependent group undertaking having its registered office within the Community and through which other group undertakings are dominated shall draw up consolidated sub-group accounts and a sub-group annual report where one of these undertakings is established as one of the types of company referred to in paragraph 1(a). However, this requirement does not apply to a dependent group undertaking which has not been established as one of those types of company provided that the dominant group undertaking publishes group accounts in conformity with the provisions of this Directive.

The annual accounts of all undertakings forming part of the sub-group without regard to where their registered offices are situated, shall be consolidated. The consolidated sub-group accounts shall be drawn up as of the same date as the annual accounts of the dependent group undertaking which has to draw up the consolidated sub-group accounts.

(b) Consolidated sub-group accounts and a sub-group annual report shall also be drawn up where the registered office of the dominant group undertaking is situated outside the Community and one or more dependent group undertakings having their registered office within the Community are placed at the same level towards the dominant group undertaking and where one of those dependent group undertakings or one of the group undertakings dominated through them is established as one of the types of companies referred to in paragraph 1(a). This requirement applies to each dependent group undertaking which is placed at the same level within the group and nearest to the dominant group undertaking. However, where none of these undertakings is established as one of the types of companies referred to in paragraph 1(a), only one of them needs to draw up the consolidated sub-group accounts and the sub-group annual report.

In the consolidated sub-group accounts referred to in the preceding subparagraph shall be consolidated the annual accounts of all the dependent group undertakings referred to in the second sen-

tence of the preceding subparagraph as well as of all other group undertakings dominated through them without regard to where their registered offices are situated. The second sentence of paragraph 2(a) applies.

(c) The provisions of Articles 9 to 25 also apply to the consolidated sub-group accounts and the sub-group annual report referred to in (a) and (b) of this paragraph.

Article 7

1. Each group undertaking within the meaning of Article 4(1) whose registered office is situated within the Community shall draw up group accounts and a group annual report, where either that undertaking itself or a dependent group undertaking within the meaning of Article 4(2) is established as one of the types of companies referred to in Article 6(1)(a). In the latter case, only one of the group undertakings within the meaning of Article 4(1) needs to draw up the group accounts and the group annual report.

2. The provisions of Article 6(1)(b) and (2) of Articles 9 to 25 shall also apply in respect of the group accounts and group annual report referred to in this Article.

Article 8

In so far as is possible, the Member States shall apply the provisions of this Directive regarding the presentation of group accounts and consolidation principles where a group undertaking is a credit institution or an insurance company.

Section 3

Drawing up of group accounts

Article 9

1. The group accounts shall comprise the group consolidated balance sheet, the group consolidated profit and loss account and the notes to the accounts. These documents shall constitute a composite whole.

2. The group accounts shall give a true and fair view of the group's assets, liabilities, financial position and results.

3. They shall be presented clearly and in conformity with the provisions of the Directive.

Article 10

1. A group undertaking may be omitted from a consolidation if it is of only minor importance for the purposes of Article 9(2) of this Directive. Application of this provision must be indicated in the notes to the accounts.

2. Where several group undertakings satisfy the requirement of paragraph 1, they shall nevertheless be consolidated if those undertakings taken as a whole are of a certain importance for the purposes of Article 9(2) of the Directive.

Article 11

Without prejudice to the provisions of Article 12 below Articles 3 to 27 of Directive No ....[1] of .... shall apply in respect of the presentation of group accounts.

Article 12

1. (a) The book values of holdings in the capital of undertakings whose accounts are consoli-

[1] Amended proposal for a fourth Directive on annual accounts, Supplement 6/74 — Bull. EC.

dated shall be compensated with the corresponding percentage of the capital of the undertakings in question including reserves, results and results brought forward. This compensation shall be carried out on the basis of the values existing at the moment of the acquisition of these holdings. Differences arising from compensation shall be entered directly against the relevant items in the group consolidated balance sheet. Any balance not so attributable shall be shown as a separate item with an appropriate heading. Amounts entered under this item shall be explained in the notes to the accounts.

(b) By way of derogation from paragraph 1(a), holdings in the capital of the group's dominant undertaking held by dependent group undertakings whose accounts are consolidated shall not be consolidated. Such holdings shall be shown in the group accounts as the group's own shares.

2. Without prejudice to the provisions of Articles 14, 15, 17 and 18, the asset and liability items in the balance sheets of group undertakings whose accounts are consolidated shall be incorporated in full in the group consolidated balance sheet. Shares held by persons outside the group in the capital, reserves, results or results brought forward of such dependent group undertakings shall be shown as a separate item with an appropriate heading.

Article 13

Without prejudice to the provisions of Articles 14, 15, 17 and 18, income and expenditure shown in the profit and loss accounts of group undertakings whose accounts are consolidated shall be incorporated in full in the group consolidated profit and loss account. Shares held by persons outside the group in the results of dependent group undertakings shall be shown as a separate item with an appropriate heading in the group consolidated profit and loss account.

Article 14

1. Group accounts shall be drawn up in accordance with the following general principles:

(a) the methods of consolidation may not be changed from one year to the next;

(b) debts and claims between group undertakings whose accounts are consolidated shall be eliminated;

(c) income and expenditure relating to transactions between group undertakings whose accounts are consolidated shall be eliminated;

(d) profits relating to transactions between group undertakings whose accounts are consolidated shall be eliminated;

(e) annual accounts which are included in the consolidation shall, in so far as is possible, be drawn up as of the same date as the group accounts. Where the financial year of a group undertaking does not coincide with that adopted for the group accounts, the accounts of that undertaking may be consolidated only on the basis of audited interim accounts drawn up as at year-end for the group.

2. (a) Departures from the general principle set out in 1(a) shall be permitted in exceptional cases. Where the principle is departed from, an indication thereof shall be given in the notes to the accounts, together with an explanation of the reasons therefore, and an assessment of the effect on the group's assets, liabilities, financial position and results.

(b) Departures from the general principle set out in 1(d) shall be permitted where the transaction related to a fixed asset which has a limited useful life and has been concluded according to normal market conditions. Where the principle is departed from, an indication thereof shall be given in the notes to the accounts.

Article 15

Valuation of items in the group accounts shall be carried out in accordance with the following general principles:

(a) items included in the consolidation shall be valued in conformity with Articles 28 to 39 of Directive No .... of ....[1];

[1] Amended proposal for a fourth Directive on annual accounts, Supplement 6/74 Bull. EC.

(b) the same valuation rules must be applied in drawing up annual accounts to be included in the consolidation. Departures from this principle shall be permitted in exceptional cases. Where the principle is departed from this shall be indicated, together with the reasons therefore, in the notes to the accounts, and items valued in accordance with different rules shall be consolidated only after having been valued in accordance with the valuation rules applied by the dominant group undertaking;

(c) without prejudice to the provisions of Article 12(1)(a), 14(1)(d), paragraphs (a) and (b) above and Articles 17 and 18, the same values must be ascribed to the items incorporated in the group consolidated balance sheet as in the balance sheets of group undertakings;

(d) deferred taxation arising in consolidation shall be taken into account. Such taxation shall be shown separately either in the group consolidated balance sheet and profit and loss account or in the notes to the accounts.

Article 16

Differences arising in consolidation which, pursuant to Article 12(1)(a), have been entered against the relevant items in the group consolidated balance sheet shall be dealt with in accordance with the rules laid down in Articles 29 to 39 of Directive No .... of ....[1]

Where consolidation differences cannot be entered wholly or in part against the various items in the group consolidated balance sheet and are shown as such as a separate item on the assets side, the value of that item shall be written off over a maximum period of five years.

Article 17

1. Holdings of group undertakings in the capital of undertakings which are associated with group undertakings within the meaning of Article 1 of this Directive, shall be shown in the group consolidated balance sheet as a separate item with an appropriate heading.

2. The following principles shall apply to the valuation in the group consolidated balance sheet of the holdings referred to in paragraph 1:

(a) The amount of any differences existing when such holdings were acquired between their purchase price and the corresponding percentage of the capital of such associated undertakings, including reserves, results and results brought forward, shall be shown separately in the group consolidated balance sheet or in the notes to the accounts. The values making up this amount shall be analysed in the notes to the accounts. For the purpose of valuing the holdings in question in the group consolidated balance sheet, the various components making up these differences shall be dealt with in accordance with the provisions of Article 16.

(b) The purchase price of holdings in the capital of an associated undertaking shall be increased or reduced in the group consolidated balance sheet by the profits or losses realized by this undertaking on a *pro rata* basis according to the percentage of capital held by the group undertaking. These amounts shall be shown each year in the group consolidated profit and loss account as a separate item with an appropriate heading. Where the associated undertaking distributes dividents to the group undertaking, the book value of the holding in the group consolidated balance sheet, shall be reduced accordingly.

(c) The provisions of Article 14(1)(d) shall be taken into account.

3. Application of paragraphs 1 and 2 above may be waived where the holding in the capital of the associated undertaking is of only minor importance for the purposes of Article 9(2) of this Directive. Such waiver must be indicated in the notes to the accounts.

Article 18

1. Where a group undertaking manages another undertaking jointly with one or more undertakings which do not form part of the group, Member States may authorize the accounts of that undertaking to be consolidated in the group

[1] Amended proposal for a fourth Directive on annual accounts, Supplement 6/74 — Bull. EC.

accounts on a *pro rate* basis according to the percentage of capital held by the group undertaking.

2. Articles 9 to 16 shall apply *mutatis mutandis* to the proportional consolidation of accounts referred to in paragraph 1.

3. Where this Article applies, Article 17 shall not apply if the undertaking whose accounts are consolidated on a proportional basis is an associated undertaking within the meaning of Article 17.

Article 19

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

Article 20

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

1. the valuation methods applied to the various items in the group accounts, and the methods employed in calculating the value adjustments. For items in the annual accounts of group undertakings in foreign currency which have been incorporated in the group accounts, the rates of exchange used for their conversion into local currency must be indicated;

2. the name and registered office of group undertakings whose accounts have been consolidated, the percentage of the capital held in those undertakings and the legal relationships between them. The same information must be given in respect of group undertakings whose accounts have not been consolidated pursuant to Article 10;

3. the name and registered office of undertakings associated with a group undertaking and which appear in the group accounts pursuant to Article 17, and the percentage of the capital held in such undertakings. The same information must be given in respect of undertakings associated with a group undertaking to which Article 17(3) has been applied;

4. the name and registered office of undertakings whose accounts have have been consolidated on a proportional basis pursuant to Article 18 together with the percentage of the capital held in such undertakings;

5. the name and registered office of undertakings other than those referred to in paragraphs 2, 3 and 4 above, in which group undertakings hold not less than 10 % of the capital, stating the percentage of the capital held and the subscribed capital, reserves and results for the most recent financial year of the undertaking in question;

6. the overall amount of financial commitments outside the group which are not shown in the group consolidated balance sheet, in so far as this information is of assistance in assessing the financial position of the group. Commitments existing with regard to undertakings which do not form part of the group but are affiliated with a group undertaking shall be shown separately;

7. the net amount of the group's turnover, broken down by category of product and activity, and by geographical market. The amount contributed by each category and market to the group's result for the year must be indicated;

8. the number of persons employed by group undertakings during the year, broken down by category, and, if they are not shown separately in the group consolidated profit and loss account, the whole of the personnel costs relating to the accounting period, broken down as provided in Article 20, point I. 6 of Directive No .... of ....;[1]

9. the taxes included in the operating result, the financial result or the exceptional result of the group;

10. the amount of the changes in the group's result for the year due to the application of tax laws.

[1] Amended proposal for a fourth Directive on annual accounts, Supplement 6/74 — Bull. EC.

Article 21

1. Member States may allow the particulars stipulated in Article 20, points 2, 3, 4 and 5:

(a) to take the form of a statement filed in accordance with Article 3(1) and (2) of Directive 68/151/EEC of 9 March 1968.[1] This shall be indicated in the notes to the accounts;

(b) to be omitted when their nature is such that, in the view of a reasonable businessman, they would be seriously prejudicial to any of the undertakings to which these provisions relate. The omission of the particulars shall be mentioned in the notes to the accounts.

2. Member States may allow the particulars stipulated by Article 20, point 7 to be omitted where the requirements laid down in Article 24 of Directive No .... of ....[2] are satisfied by the group as a whole. The second paragraph of Article 24 of that Directive shall apply.

Section 4

Group annual report

Article 22

1. The group's annual report shall contain a detailed review of the development of the group's business and of its position.

2. The report shall also give particulars of:

(a) important events that have occurred since the year-end;

(b) the group's likely future development;

(c) the activities of the group with regard to research and development and the costs thereof.

[1] First Council Directive of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, OJ L 65 of 14.3.1968.
[2] Amended proposal for a fourth Directive on annual accounts, Supplement 6/74 — Bull. EC.

Section 5

Audit

Article 23

1. (a) The dominant group undertaking shall cause the group accounts to be audited by one or more persons authorized by national law to audit accounts.

(b) The person or persons responsible for auditing the accounts shall also verify that the group annual report is consistent with the group accounts of that financial year.

2. (a) Member States may waive the compulsory auditing provisions of paragraph 1 where the requirements laid down in Article 49(2) of Directive No .... of ....[1] are satisfied by the group as a whole and where none of the group undertakings is established under any of the forms specified in Article 1(1)(a) of that Directive. The third subparagraph of Article 49(2) of that Directive shall apply.

(b) Where paragraph 2(a) is applied, the Member States shall introduce appropriate sanctions into their law for cases in which group accounts and group annual reports are not drawn up in accordance with the requirements of this Directive.

Section 6

Publication

Article 24

1. (a) Group accounts, the group annual report and the report submitted by the person responsible for auditing the accounts shall be published by the dominant undertaking of the group in the manner provided in Article 44 of Directive No .... of .....[1]

(b) Articles 45 and 46 of that Directive shall also apply.

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

(a) the publication merely of a group consolidated balance sheet abridged as provided in Article 50(2)(b) of Directive No .... of ....,[1] and of notes to the accounts not necessarily including the explanations required under Article 20, points 6 to 10, of this Directive. Such derogation shall be permitted only where the requirements laid down in Article 49(2) of Directive No .... of ....[1] are satisfied by the group as a whole and where none of the group undertakings is established under any of the forms specified in Article 1(1)(a) of that Directive. The third subparagraph of Article 49(2) of that Directive shall apply;

(b) publication to be effected only as prescribed by Article 3 of Directive 68/151/EEC of 9 March 1968. Such derogation shall be permitted only where the requirements laid down in Article 50(2)(a) of Directive No .... of ....[1] are satisfied by the group as a whole and where none of the group undertakings is established under any of the forms specified in Article 1(1)(a) of that Directive. The second subparagraph of Article 50(2)(a) of that Directive shall apply.

[1] Amended proposal for a fourth Directive on annual accounts, Supplement 6/74 — Bull. EC.

Section 7

Final provisions

Article 25

1. When the first group accounts are drawn up pursuant to this Directive, the book value of a holding and the percentage of the capital that it represents at the time of such first consolidation pursuant to this Directive may be taken into account for purposes of application of Article 12(1)(a) of this Directive. Any difference between these two values which represents a liability shall be entered against group reserves in the group consolidated balance sheet.

2. The provisions of paragraph 1 shall apply *mutatis mutandis* to the valuation pursuant to Article 17(2) of a holding in the capital of an undertaking associated with a group undertaking and to the proportional consolidation according to Article 18.

Article 26

1. Member States shall, within eighteen months of notification of this Directive, make all the amendments to their laws, regulations and administrative provisions necessary to comply with the provisions of this Directive, and shall forthwith inform the Commission thereof. They shall bring such amendments into force within thirty months of notification of this Directive.

2. The Member States shall communicate to the Commission the texts of the esential provisions of internal law which they adopt subsequently in the field covered by this Directive.

Article 27

This Directive is addressed to the Member States.

Explanatory memorandum

17-18

In 1971, the Commission submitted to the Council a Proposal for a fourth Directive pursuant to Article 54(3)(g) of the EEC Treaty for coordination of national legislation regarding the annual accounts of limited liability companies.[1] This proposed directive relates to the annual accounts of individual companies.

A growing number of companies, particularly limited liability companies, now no longer carry out their industrial or commercial activities on a footing of complete economic independence. They are linked with other companies to form larger and more complex units which it has become usual to refer to as groups of companies. The basic characteristic of such groups is that the management of the companies belonging to them is coordinated in such a way that they are managed on a central and unified basis by the dominant company or companies in the interests of the group as a whole.

It is clear that where a company is linked with other companies to form a group, the annual accounts of that company alone will not be sufficiently comprehensive to give a true impression of its position, which will be closely linked with the overall position of the group. Only by consolidating the individual accounts of all the companies belonging to the group, i.e., by drawing up group accounts, is it be possible to obtain a true and fair view of the economic and financial position of the group and through it, a more complete picture of the position of the individual company.

Some Member States have already taken account of this process by introducing the legal requirement to draw up consolidated accounts in respect of limited liability companies or certain categories thereof.

The purpose of this Proposal for a Directive is to institute a system of Community legislation on consolidated accounts. Such legislation is a necessary extension to the fourth Directive on annual accounts and has the same objective: to ensure that consolidated accounts are laid down with regard to the information to be supplied in such accounts in order to provide certain minimum standards for the protection of shareholders, employees and third parties in all the Member States, thus making it easier for companies to exercise their right of establishment; to enable a common market of undertakings to be established; to provide the right conditions to enable a European capital market to function; and finally to avoid a situation where various legal requirements relating to the way in which accounts are presented distort competition between companies within the Community.

The harmonization of national laws on group accounts would also make a contribution to the work currently in progress at various levels to take better account of the situation relating to multinational companies and, if possible, to provide an appropriate legal framework for them.[2] Following this process of harmonization, multinational companies having their registered offices in the Community will be required to draw up and publish clear and complete information which will ensure that their relationships with other group companies, as well as their activites, will be clearly visible. Such companies will have to publish consolidated accounts covering all their affiliated companies throughout the world and drawn up on the basis of principles and methods of consolidation which are uniformly applicable throughout the Community. These provisions also apply to multinational companies having their registered offices outside the Community as far as their activities through companies established in the Community (subgroup) are concerned.

In this Proposal for a Directive, the Commission has followed an overall strategy which attempts to deal as effectively as possible with the economic realities of groups of companies. Both the definition of groups of companies and the methods and principles of consolidation are based on the established economic reality that groups of companies function as an economic unit in which economic and financial policy is determined, at least as regards its main lines, on a centralized basis in the interest of the whole entity constituted by the group. Group accounts should give a true and fair view of this economic unit. Individual accounts, for example, should thus be fully consolidated, consolidation should refer to the date on which the relevant holding was acquired, transactions within a group should be eliminated, and all items comprising the group's assets and liabilities which are consolidated should be valued in accordance with identical principles.

However, the Commission has defined the methods and principles for consolidation only in general terms in order to allow for rapid evolution in the moving field of consolidation of accounts.

[1] Supplement 7/71 — Annex to Bull. EC 12-1971.
On 26 February 1974, the Commission submitted an amended proposal for a fourth Directive to the Council pursuant to the second paragraph of Article 149 of the EEC Treaty, Supplement 6/74 — Bull. EC.

[2] See the communication from the Commission to the Council of 8 November 1973 on multinational undertakings in the context of Community regulations, Supplement 15/73 — Bull. EC, in particular Chapter III G.

Section I

Definitions

The first section contains the definitions of a number of terms which are necessary in order to draw up group accounts and more particularly to enable the scope of consolidation to be properly defined. These definitions do not exceed the limits of what is necessary for the purposes of this Directive and do not prejudice any solutions which might be contained in a Directive on the harmonization of the law relating to groups of companies.

Article 1

The term 'associated undertaking' refers to undertakings which, while not belonging to the group, have a significant influence exerted over them by a group undertaking. Article 17 lays down a special system for valuing in the group accounts the holdings of group undertakings in the capital of such undertakings. Such enterprises cannot be fully consolidated since they are not part of the group. They are, however, so closely linked with the group that this must be taken into account when valuing the holding in that undertaking for the group accounts. A practical example of an associated undertaking is an undertaking managed jointly by several other undertakings (joint venture). Since the group is directly involved in managing an associated undertaking through the exercise of a significant influence, the group accounts should reflect the effects of such involvement, in particular by taking account, when a holding in the capital of such an undertaking is valued, of the results, (even if undistributed), proportion to the size of the holding in the association undertaking. This valuation system is explained more fully in the notes on Article 17.

The criterion used to define an associated undertaking is of necessity somewhat vague. The introduction of strict and precise criteria would make it impossible to cover the many forms and means existing in economic practice for exercising a significant influence on the running of an undertaking. The practical application of the definition is simplified, however, by the introduction of a rebuttable presumption that a significant influence is exerted where 20 % or more either of an undertaking's capital or of the votes attaching to shares issued by an undertaking is held by another undertaking. Moreover, where the holding exceeds 50 %, the initial presumption is that one of the undertakings concerned is dependent upon the other.[1] In this case the presumption in Article 1(2) applies only where the stronger presumption in Article 2(2) has been rebutted.

The definition is purposely based on the fairly wide concept of the undertaking. There would be no justification in limiting the scope of the relevant articles to certain legal forms such as, for example, limited liability companies, since investments which allow a significant degree of influence to be exerted may be held in all forms of undertaking.

A significant influence may also be exerted indirectly, particularly where holdings in the capital of the associated undertakinig are wholly or partly held by a dependent undertaking within the meaning of Article 2. The different forms which such an indirect holding may take are defined in Article 1(3).

Articles 2 and 3

The definitions contained in the national laws governing group accounts of undertakings belonging to a group, which are given in order to determine whether they should be included in the group accounts, vary widely. There are in fact two approaches which differ quite fundamentally. In one Member State, the term 'group undertaking' is given a very wide definition in an obvious attempt to take account of the economic realities behind groups of companies which, while apparently a collection of legally autonomous undertakings, operate in practice as an economic unit. In other Member States, however, the law provides much clearer and more concrete definitions using, for example, criteria such as who holds the majority of the capital or how the majority of the voting rights attaching to the shares issued by a company are distributed.

It is vital for the successful harmonization of the law in the field of consolidation that the Directive should provide a uniform definition of groups of companies. Any other solution embodying for example the varying defintions already used in the Member States would destroy the comparability of group accounts as well as the equivalence of the information which would be produced at the Community level. This kind of solution would also be unacceptable with regard to the amount of coherent and adequate information to be provided by multinational groups of companies with registered offices situated in the Community.

This being so, a choice has to be made between the different approaches taken by the Member States. The Commission is in favour of a general and wide-ranging definition of groups of companies which attempts to come to grips with the economic realities of the situation. Precise definitions were considered too rigid and inflexible to take account of the many forms assumed by groups of companies. In addition, if the definition of an undertaking belonging to a group is any undertaking in which the majority of the capital or the majority of the voting rights attaching to the shares issued is held, no account can be taken of those special cases where one undertaking controls another while having no desire to influence the management of the latter. Such cases arise for example

[1] Article 2 (2).

where a dominant undertaking views its controlling interest as a mere investment, or where a bank has for one reason ore another acquired the majority of the shares in a company which it wishes to sell within a short time. In this kind of situation, the dominant undertaking does not incorporate the dependent undertaking into a group managed on a uniform basis and there is therefore no justification in considering such undertakings as being controlled in the same way as group undertakings.

It is interesting moreover to note that the legal systems which define groups precisely do not require group undertakings to be included in the consolidated accounts on a compulsory basis. Under such systems, group accounts do not necessarily have to be drawn up along the lines of consolidated accounts and/or wide ranging exemption clauses have been introduced which allow group undertakings to be excluded from the group accounts.

The Commission does not consider it desirable that the drawing up of consolidated accounts should be merely optional. If a group exists, consolidating the annual accounts of the undertakings belonging to the group is the only way in which to meet the justifiable need on the part of all concerned for information. Moreover, wide-ranging exception clauses appear to be no more of a satisfactory solution, since they will continuously be liable to abuse and will cause the Directive to be applied unevenly, since they will in practice be interpreted subjectively. The Commission has for these reasons decided upon a definition of groups of companies which is in itself sufficiently flexible to take account of the specific cases which occur in practice and which makes exception clauses superflous.

A precise definition of the kind referred to above is, moreover, much too limited in scope, since it disregards the question of minority holdings. It is a fact that even where a majority of the capital of an undertaking is not held, control may in many cases be gained and the undertaking integrated into the group. There is, therefore, no reason to omit such cases from the consolidation, provided at least that the dominant undertaking is in a strong enough position to ensure that it has stable and not merely fortuitous or temporary control.

The Commission has, for all these reasons, defined groups of companies in the Proposal by distinguishing those characteristics which they possess in practice in economic reality. There are in fact two. In order for a group to exist, control must first of all be possible. This aspect is defined in Article 2: the power to exercise a dominant influence is the characteristic which establishes a relationship of dependence. Then, this feasibility must be acted upon so that control is in fact exercised. This second aspect of groups of companies is defined in Article 3, which provides that the entity composed of the dominant undertaking and one or more dependent undertakings should be managed on a central and unified basis by the dominant undertaking.

The concept of 'being managed on a central and unified basis' requires some interpretation. It is not, however, a theoretical concept with little relation to reality. On the contrary, the general formula 'being managed on a central and unified basis' takes account of the way in which undertakings which are legally autonomous but which function as an economic unit are run. This formula automatically distinguishes those cases referred to above in which an undertaking may potentially be controlled but where that control is not exercised in practice. In addition, it includes those cases in which control is exercised on the basis of minority holdings.

Objections that such vague formulas as 'dominant influence' and 'managed on a central and unified basis' are difficult to apply in practice are refuted by the fact that clear and precise presumptions are provided for in the Directive in respect of the application of these two formulas. Thus a majority holding in the capital of an undertaking gives rise to the presumption, which is in fact rebuttable, that a relationship of dependence exists; this dependence gives rise in its turn to be presumption, which is also rebuttable, that the undertakings are managed on a central and unified basis. These presumptions will, in practice, constitute firm and almost automatic evidence in the majority of cases that a group exists.

With regard to Article 2 in particular, the Commission has refrained from defining the manner in which a dominant influence may arise. In practice, it is most commonly effected by a combination of legal and factual means. There is no justification for limiting the scope of Article 2 to cases in which the dominant influence is achieved solely by legal means. It is in addition clear that a dominant influence cannot develop without a degree of stability. A situation whereby it might be possible to control an undertaking for a brief period as a result of coincidental circumstances will also be excluded from the scope of Article 2(1).

As in Article 1, Articles 2 and 3 refer to undertakings without further reference to their legal form. The actual legal form of the undertakings concerned is in fact of little importance with regard both to the relationship of dependence and to the group relationship.

The presumptions in Article 2(2) may be rebutted. It goes without saying that the rebuttal of one of these presumptions will not prevent another from applying. A majority holding in the capital of an undertaking may not be sufficient to enable a dominant influence to be exerted where this holding consists of shares not having voting rights. The same may also apply in respect of the holder of a majority of the voting rights where, e.g., the rules governing the constitution of the undertaking concerned systematically require more than a mocre majority or a qualifued majority any decision above a certain degree of importance. Finally, the presumption based on the circumstances in paragraph 2(c) may be rebutted where more than half of the members of the undertaking's relevant bodies are appointed without a power on the part of the dominant undertaking to dismiss them, or where important deci-

sions must always be approved by another body whose composition is not controlled by the dominant undertaking. Moreover, the terms 'administrative, managerial or supervisory body' were chosen to encompass the various systems used in the Member States with regard to the structure of companies (single or two tier systems).

The different ways in which an undertaking may be indirectly dependent where shares are held by a person or undertaking other than the dominant undertaking are covered in Article 2(3).

Article 3 refers only to vertical groups. Several dependent undertakings may be linked in this kind of group, but there is only one dominant undertaking in the group, which ensures from its position at the head of the group that the group is managed on a central and unified basis.

As stated above, a group is presumed to exist where an undertaking is dependent on another undertaking (Article 3(2)). This presumption may be rebutted where it can be shown that a dominant influence is not exerted in practice.

Article 4

Sometimes, especially at international level, undertakings band together to form horizontal groups or consortia. The basic characteristic of this kind of group is the same as that defined in Article 3, i.e. the undertakings concerned are managed on a central and unified basis. In this particular case, however, the central and unified management is not provided by one dominant group undertaking, but jointly by the undertakings concerned. Such undertakings operate on the basis of equality *vis-à-vis* one another. In other words, there is no interrelationship of dependence in horizontal groups, at least between the undertakings which provide the central and unified management at the head of the group. Various means may be employed to ensure that the group is managed on a central and unified basis, such as contracts, the appointment of the same members to the administrative, management or supervisory bodies of the undertakings concerned or the setting up of a management committee which determines a unified management policy and to which all or some of the members of the administrative bodies etc. of the undertakings concerned are appointed.

The Commission believes that those same arguments which militate in favour of consolidating the accounts of vertical groups may be advanced to justify requiring the accounts of horizontal groups to be consolidated.[1] The undertakings concerned are in practice managed as an economic unit and all those with an interest in the state of each undertaking taken individually have an equal interest in being informed of the state of the group, since the position of the individual undertaking is to a large extend determined by it.

It is possible that undertakings belonging to a horizontal group have holdings in other undertakings which are dependent undertakings and in their turn subject to the central and unified system of group management. It therefore seems logical to regard the latter type of undertaking as being group undertakings also. In this situation, horizontal groups have also the characteristics of vertical groups, and are in fact vertical groups headed by several undertakings (paragraph 2).

It is important to distinguish this kind of structure very carefully from the situation where an undertaking is managed jointly by two or several other undertakings. All the undertakings belonging to a vertical group headed by several undertakings are managed in a central and unified basis and therefore constitute an economic unit. This justifies drawing up group accounts.[1] In the second situation, however, there is only one undertaking which is managed jointly by two or several other undertakings, although this collection of undertakings is not managed on a central and unified basis. There is thus no justification for drawing up groups accounts in respect of such jointly held companies, although they may possibily be valued according to the 'equity method'[2] or consolidated on a proportional basis.[3]

Article 5

The concept of affiliated undertakings covers a number of different relationships whereby undertakings may be linked, but which are so close that they have to be referred to in various contexts in both the annual accounts and the group accounts. This definition plugs a gap in the Proposal for a fourth Directive which already employs the concept of the affiliated undertaking, particularly in the layouts, required for the balance sheet and profit and loss account, without however defining it.[4]

'Affiliated undertakings' is merely a collective concept which covers the different kinds of relationship between undertakings defined in the four initial articles of this Proposal.

This special concept, which is used primarily for the purposes of the fourth Directive, is also of use in the Proposal, particularly with regard to the lay-out of group accounts[5] and the notes to group accounts.[6]

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[1] Article 7.
[2] Article 17.
[3] Article 18.
[4] Article 51 (2) of the proposal for a fourth Directive, Supplement 6/74 — Bull. EC.
[5] Article 11.
[6] Article 20.

Section 2

Scope

Article 6

The purpose of this Directive in requiring group accounts to be drawn up is to protect the interests linked with limited liability companies. The drawing up and publication of the annual accounts for the same legal forms of companies are governed by the fourth Directive.

Article 6, which defines the scope of this Directive, deals in its first paragraph with the establishment of group accounts when the dominant group undertaking has its registered office in the Community. Two possible situations should be distinguished.

Firstly, the dominant group undertaking itself may be one of the types of limited liability company referred to above. It is the clearest situation in which group accounts are required to be drawn up in order to ensure that all those with an interest in the company are kept sufficiently informed.

The second situation is where it is not the dominant group undertaking but one of the dependent group undertakings which is established in one of the legal forms covered by the fourth Directive. The dominant group undertaking in this situation also is required by the Directive to draw up group accounts, not in order to protect persons having an interest in that undertaking, but rather in the sole interest of the dependant group company. Since such companies belong to the group, it follows that as their position will largely depend on the position of the group as a whole, shareholders and third parties concerned in dependent group companies will have every interest in being kept properly informed of the group's position. Moreover, it would be too easy to find loopholes in the Directive if it did not impose such an obligation. It would suffice to put at the head of the group an undertaking which was not a limited liability company to be able to get round the requirement to draw up consolidated accounts.

The group accounts to be drawn up pursuant to paragraph 1 must include the annual accounts of all undertakings belonging to the group (paragraph 1(b)). This process of consolidation is compulsory, as Article 9(1) also lays down. As stated above, the Commission considers that a true and fair view of a group's position can be given only by fully consolidating the accounts. The Directive therefore does not allow group accounts to be presented in the form merely of a collection of statistics derived from the annual accounts, or in the form of the individual accounts of a company otherwise excluded from consolidation. The Directive permits a group undertaking to be omitted from consolidation only where it is of minor importance.[1]

Group undertakings with registered offices outside the Community are also included in the scope of the Directive. There is no reason why they should be excluded. Without them the group accounts would give only a distorted and incomplete picture of the group's position. The Directive takes account in the provisions on the principles of consolidation[2] of the special problems which might arise when the accounts of such undertakings are consolidated, particularly as a result of differences in valuation methods. In addition, it should be borne in mind that the connection with a group undertaking situated outside the Community may sometimes be complicated by the fact that transfers of profits or assets are restricted or even prohibited by the country in which that undertaking is situated. It would if necessary be justifiable in such circumstances to omit such an undertaking from consolidation, where the process of management on a central and unified basis has been obstructed to the extent that the undertaking concerned can no longer be regarded as belonging to the group.

A dominant group undertaking as defined in Article 3 which is required under Article 6(1) to draw up group accounts must be the undertaking which heads the group. The Directive also provides for consolidated accounts to be drawn up in respect of sub-groups (paragraph 2).

Provision is first made (paragraph 2(a)) for the situation in which the group is organized at different levels and in which, through the intermediary of a dependent group undertaking other group undertakings are dominated (sub-group). The Directive requires the drawing-up of consolidated accounts and an annual report for a sub-group where one of the undertakings which are members has the form of a limited liability company.

This provision convers both the case in which the dominant enterprise of the group, having its registered office outside the Community does not draw group accounts, and the converse case in which the head of the group is situated within the Community and is subject to the provisions of the Directive.

In the former case, the drawing up of consolidated accounts for the sub-group is justified by the absence of consolidated accounts for the group as a whole. In the latter case, the sub-group consolidated accounts are to be drawn up in addition to the group accounts which are also obligatory. Only when the undertaking at the head of a sub-group is not a limited liability company does the Directive dispense with the requirement for the drawing up of consolidated accounts for the sub-group. Indeed, in this case, the interest linked to the limited companies at a lower level of the sub-group are considered to be sufficiently protected by the presentation of group accounts by the dominant enterprise of the group.

Why, in other cases, is the drawing up of consolidated accounts for a sub-group still thought necessary when consolidated accounts are already available for the group as a

[1] Article 10.
[2] Articles 14 and 15.

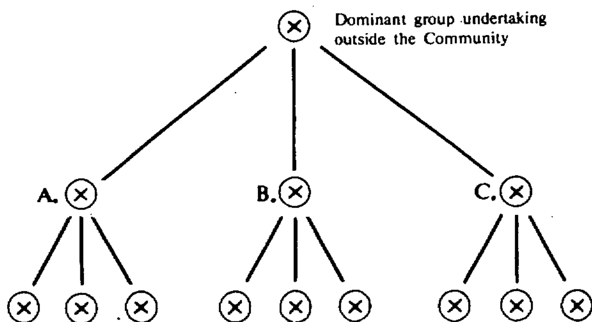
whole? The Commission considers that sub-group accounts play a useful part in supplementing the information already given in the group accounts and add to the protection of the various parties having an interest in dependent group companies required to draw up such accounts. The shareholders and creditors of such companies obtain a better view of their company's position, since in place of a mere reference to the book value of their holdings, a complete rundown is given of the situation and activities of that part of the group in which they are particularly concerned. Obviously, this provides no more than supplementary information in addition to that given in the company's annual accounts and the group accounts. Moreover, this information cannot be evaluated without these other two documents. The situation might arise, for example, where the sub-group accounts showed a profit while the group accounts showed a loss. Both sets of information are important for shareholders in dependent group companies.

There is some danger of group accounts, and in particular those of large groups with a large number of operations in different countries, becoming a jumble in which a great deal of important information is lost. This is why the Commission considers it necessary for more specific information to be given on the activities and results of sub-groups, at least where a limited liability company heads it. This does not contravene the 'economic unit' principle, which the Commission continues to accept in full, nor does it imply that the group is subdivided into several groups. It should be borne in mind that while a group represents itself as an economic unit, it consists of a number of legally autonomous undertakings, each of which has its own circle of interested parties. These two aspects of the group should be fully taken into account in dealing with the publication of accounts.

Supplementary information given in sub-group accounts is intended not only for shareholders in the dependent group company concerned, but also for other interested parties such as creditors and employees. Even the interests of the region or State in which the company is situated may be involved, depending upon the importance of the company concerned. There would therefore be no justification for exempting dependent group companies from drawing up sub-group accounts where all the capital in the company is held by the group. The same reasoning has restrained the Commission from inserting a special exception whereby companies would not have to publish annual accounts if they had been incorporated into the consolidated accounts. Even where such companies do not have any shareholders outside the group and its creditors are protected by a guarantee by the dominant group undertaking to pay its debts, certain specific information on the company which can only be given in the form of annual accounts remains valid and certainly of value to other categories of interested party such as those referred to above.

Paragraph 2(b) applies to the case in which a group of companies is managed from outside the Community, though within the Community several dependent group companies or sub-groups are established on the same level in relation to the dominant undertaking of the group. In other words, these dependent group companies or sub-groups are independent of each other and are dominated only by the dominant undertaking of the group from outside the Community. In such a possible situation in which there are no group accounts, it would be highly desirable for the interested parties to have an overall picture of all the group activities in the Community. The consolidation for a Community sub-group, as in the other cases, is required only when one of the undertakings which is a member of the sub-group is a limited liability company.

A typical situation in which paragraph 2(b) would apply is presented by the following example:



The dependent group undertakings A, B and C are limited companies established within the Community each of which is situated at the head of a sub-group within the Community. As a result of the application of paragraph 2(a), they must each establish consolidated accounts for their sub-group. The provisions of paragraph 2(b) oblige them in addition to draw up consolidated accounts for the entire part of the group which is situated within the Community, that is to say, that these accounts, in the above example, must include the three sub-groups A, B and C in their entirety. This consolidation resembles that required by Article 7 of this Directive for horizontal groups, both as regards scope and procedure. Accordingly, for further details, reference may be made to the notes on that Article.

The complementary publicity which is provided for in this particular case is justified by the better picture which may thereby be obtained of the situation of the part of group within the Community. Thus, in particular, all transactions between undertakings of the group in question must be eliminated. The provisions of paragraph 2(b) are especially important as regards multinational groups which, while being controlled from outside the Community, have multiple interests and activities inside the Community.

Article 7

It has already been stated in the notes on Article 4 that group accounts must also be drawn up in respect of horizontal groups where one of the undertakings belonging to the group is a limited liability company. Anyone with an interest in being kept fully informed of the position of the group to which that company belongs. Horizontal groups should also be required, since they constitute economic units in the same way as vertical groups, to draw up consolidated accounts and eliminate dealings between group undertakings, etc.

The actual consolidation procedure will be slightly different for horizontal groups, since the capital in undertakings heading the horizontal group and between which no relationship of dependency exists will not be consolidated.[1] The annual accounts of these undertakings will be incorporated in the group accounts in the form of combined accounts also drawn up in accordance with the principles laid down in Articles 14 and 15.

Article 7 applies in accordance with the same principles as those laid down in Article 6. All undertakings participating in the central and unified management are required to draw up group accounts where they are companies covered by the fourth Directive. If the position of a company of this kind is merely one of dependency within the group, group accounts must also be drawn up by the undertakings heading the group. Each of these undertakings is in principle required to fulfil this obligation, although it will suffice if one of them actually draws up the group accounts.

If dependent undertakings also belong to a horizontal group,[1] consolidated sub-group accounts may have to be drawn up. In this matter, as in others, the same rules apply as in the case of a vertical group.

Article 8

The Directive also applies to groups to which banks or insurance companies belong, either at the head of the group or as dependent group undertakings. It might be useful to recall here the general concept of the group as defined in the Directive. Accordingly, where a bank has majority holdings in the capital of other undertakings which it regards as being temporary investments, those undertakings remain unequivocally outside the group and must not be taken into account in the consolidated accounts.

The Proposal for a fourth Directive exempts the Member States from applying its provisions to financial institutions such as banks or insurance companies until such time as the relevant measures have been coordinated.[1] The reason for this is that the accounts of such companies need to be structured differently from those given as a model in the fourth Directive, and as regards valuation, certain changes may also be required. The problem is being further examined by the Commission.

The Commission considers it possible and also appropriate to go futher as regards group accounts. The fact that a bank or an insurance company belongs to a group does not lessen the pressing need for group accounts. It is as necessary to eliminated intra-group profits for example in this situation as in groups having other activities. The consolidation technique laid down in the Directive can be applied perfectly to this kind of situation. In addition, the value of the information given in the group accounts will be in no way affected by the fact that this information covers a number of various activities. If problems arise, for example, with regard to the layout of group accounts, they can always be solved by inserting special headings accompanied by the appropriate notes.

It is, however, quite possible that the straightforward application of all the provisions in the Directive willl not always be possible in respect of banks and insurance companies, particularly as regards valuation. Accordingly, Article 8 provides for this application with some flexibility ('In so far as is possible'). The Commission is convinced, however, that it will be possible in most instances.

[1] Article 4 (1).
[2] Article 4 (2).
[3] Article 1 (2).

Section 3

Drawing up of group accounts

Article 9

Section 3 commences with a definition of the contents and general purpose of group accounts. The definitions given are based on the same concepts as those used in Article 2 of the Amended Proposal for a fourth Directive on annual accounts.[1]

Group accounts are to consist of three separate documents which constitute a composite whole: the group consolidated balance sheet, the group consolidated profit and loss account and the notes to the accounts. The use of the adjective 'consolidated' makes it clear that group accounts are required to incorporate in consolidated form the annual accounts of the undertakings belonging to the group. The Directive does not therefore allow group accounts to be submitted in the form of a collection of the annual accounts of the undertakings concerned.[2]

The accounts should give a true and fair view of the group's position. This objective should be constantly borne in mind by those drawing up group accounts. The purpose of the special provisions in the Directive is to make this task easier, although where some possibilities for the exercise of discretion in their application or even several possible courses have been left open, the objective of giving a true and fair view must be the basis for choosing a solution in the practical application of the Directive's provisions. It may sometimes happen that merely applying the Directive is not sufficient to give a true and fair view of the group's position. In this situation, additional information and notes should be incorporated in order to give the required true and fair view.

The principle contained in the Directive that a true and fair view of the group's position must be given is not merely a formal clause. On the contrary, it has full legal effect.

Article 10

This provision introduces the concept of materiality as regards the scope of consolidation. The same concept was also used in the Proposal for a fourth Directive in respect of the regrouping of items on the balance sheet and in the profit and loss account.[1]

If no limitations were placed on the way in which this exception clause could be applied, unacceptable consequences might result where a group consists of a large number of small undertakings and each individual undertaking fulfils the criterion of being only of minor importance, but where taken together they are of considerable importance to the group. This situation needs to be dealt with separately (paragraph 2).

No group undertakings are permitted by the Directive to be excluded from consolidation for reasons other than those given in Article 10. The flexibility of the general definition of a group must be recalled here. This permits the exclusion from consolidation of undertakings in which control is prevented from being exercised to such an extent that it no longer exists for practical purposes as well as undertakings in which control has been acquired only temporarily.

Group undertakings will not be permitted to be excluded from consolidation where their activities are very different from the normal activities of the group. A diversity of activities within a group is not in itself a valid reason for permitting undertakings to be excluded from consolidation. An individual company may also undertake different activities and will not be prevented from drawing up annual accounts. Some of the difficulties which might arise in such cases with regard to consolidation may be avoided by inserting special headings in the accounts with appropriate entries in the notes to the accounts, or by effecting a consolidation in terms of the different kinds of activity.

Article 11

There is no reason to treat groups differently from individual companies as regards the structure of the accounts. The same rules therefore apply to the presentation of accounts (order, headings) as those laid down in the fourth Directive on annual accounts. Some changes in the method of presentation are, however, required as a result of the consolidation process.[1]

Article 12

An essential part of the consolidation process is the replacement in the group accounts of the book value of holdings in the capital of the undertaking whose accounts are consolidated by the various items comprising the assets and liabilities of that undertaking. This process consists of balancing the book value of the holding and the net assets of the company in which the holding exists in proportion to the percentage of the capital held. Since in the majority of cases the book value of the holding and the corresponding percentage of the net assets are not identical, this process normally gives rise to a balance or consolidation difference which may be positive or negative. Various methods are used in the Member States to calculate and itemize these consolidation differences.

[1] Supplement 6/74 — Bull. EC.
[2] See notes on Article 6.
[3] Article 4 (3) — Supplement 6/74 — Bull. EC.
[4] Article 12.

In one Member State, consolidation is normally carried out on the basis of the net assets of the undertaking to be consolidated as it stands at the end of each financial year. Under this method, the reserves formed by the undertaking to be consolidated during its group membership will disappear into the consolidation differences and will not be shown under the group reserves in the group accounts. The consolidation differences will therefore change every year according to the movement of the reserves held in the undertaking to to be consolidated.

In other Member States, the accounts are consolidated using the 'Anglo-Saxon' method. Under this method, the book value of the holding is balanced with the corresponding percentage of the net assets as they stood when the holding was acquired. Any profits accruing after the date on which the holding was acquired and any fluctuation in reserves subsequent to that date are not therefore included in the consolidation of capital. The consolidation differences will change only as the book value of the holding or the capital and reserves as they stood when the holding was acquired vary.

Merely to implement these two methods simultaneously would be defeating the object of harmonizing the laws relating to this field. It would not be possible to compare group accounts since the information elicited under the two methods is not equivalent. A choice must therefore be made.

The Commission is in favour of the Anglo-Saxon method. This gives fuller information on the group results. This is because payments into or out of the reserves which are made at group undertaking level subsequent to its joining the group are shown directly in the group accounts as fluctuations in the group reserves instead of being buried in the obscurity of an item headed 'consolidation differences'. Results before and after an undertaking joins the group are thus kept distinct and the group's position as an economic unit and the results of its activities are clearly recorded.

The book value of the holding in the capital of an undertaking to be consolidated may be greater or less than the corresponding percentage of the net assets of that undertaking when the holding was acquired. There will therefore be a positive or negative difference between the two. In first instance, the difference may result from an additional payment made in respect of secret reserves included in the various assets of the undertaking concerned. The less frequent occurrence of a negative difference may result, for example, where certain of the assets have been overvalued or provisions have been considered to be too low.

The Directive requires that consolidation differences should be entered against the relevant items in the group consolidated balance sheet (paragraph 1(a)). This means in the examples given above that secret reserves must be included under the relevant asset items or that valuation corrections or additional provisions must be entered separately. Such direct entries give a better impression of the group's assets and liabilities and of its position than where consolidation differences are shown as a general item on the group consolidated balance sheet.

It will not always be possible, however, to give a particular reason directly concerned with the valuation of the assets and liabilities to explain why more or less has been paid for a holding than the net assets worth of the undertaking concerned. An additional sum will be paid occasionally as a means of putting a value on excellent future prospects. It may also happen that the holder of an investment has been forced by certain circumstances to assign it at too low a price. The Directive provides that if consolidation differences in such instances are not attributable, they should be shown as a separate item with an appropriate heading. An explanation of such items should be given in the notes to the accounts (paragraph 1(a)).

The method of consolidation provided in the Directive might give rise to problems when applied to holdings acquired a long time ago. A transitional solution has been included in the Directive to deal with these problems.[1]

There is a possibility that a dependent group undertaking might hold shares in the capital of the dominant group undertaking. Consolidation in this particular instance would lead to the unfortunate position where the capital in the dominant group undertaking is not incorporated in full in the group consolidated balance sheet and is reduced according to the percentage held by the dependent group undertaking. A derogation clause has therefore been inserted to cover this contingency (paragraph 1(b)). The special nature of these holdings, which are after all own shares of the group, should in any case always be made clear.

Where the book value of a holding is replaced by the items making up the assets and liabilities of the undertaking to be consolidated, it is the asset and liability items in full on the balance sheet of that undertaking which are to be included in the group accounts (paragraph 2), clearly with the exception of items covering the net assets of the undertaking. Thus the strength of the economic unit constituted by the group will be demonstrated. The Directive does not therefore permit these asset and liability items to be incorporated on a *pro rata* basis according to the percentage of the capital held except as provided in Article 18. The incorporation of such items on a proportional basis involves only a kind of consolidation of simply the financial interests held by the dominant group undertaking and does not enable a true and fair view of the position of the whole group to be obtained.

The incorporation in full of asset and liability items does not mean that these items must always be included with the amounts which they show on the balance sheets of the undertakings concerned. The implementation of other provi-

[1] Article 25.

sions of the Directive may sometimes enable the values concerned to be corrected, for example, to eliminate profits made within the group or to adapt those values to the valuation system used by the group.[1]

Where the capital in a dependent group undertaking is not held in its entirety by the group, incorporation of asset and liability items on the balance sheet of that undertaking in full in the group accounts must be balanced by taking into account shares held by persons outside the group, in the undertaking's capital, reserves, results and results brought forward. Such shares should be shown on the group consolidated balance sheet as a separate item reserved for this purpose.

Article 13

As in the case of the group consolidated balance sheet, the method of incorporating asset and liability items in full should also apply of group undertakings, corrections to the amounts shown being possible under Articles 14, 15, 17 or 18 of the Directive.[2] Shares held by persons outside the group should also be shown clearly in the group consolidated profit and loss account as a separate item specially reserved for the purpose.

Article 14

In order to impose the necessary degree of standardization in the information to be incorporated in group accounts, it is essential that a certain number of general principles be laid down governing the drawing up of group accounts and the method of valuation used in such accounts.[3] On the other hand the Directive lays down these principles in such a way that they can be applied with a degree of flexibility and that the door is also left open for any development which may be necessary in accounting practice in this field. Several of the general principles have been qualified by express exception clauses for these very reasons.

The Directive provides firstly that the principle of continuity should also apply with regard to consolidation. This applies both to the choice of method, for example those laid down in Articles 17 and 18, and the way in which they are applied (paragraph 1(a)).

Merely adding in the group accounts debts and claims between group undertakings whose accounts are to be consolidated would give a distorted view of the group's financial position and more particularly of its liquidity ratio. Such debts and claims between group undertakings must be eliminated (paragraph 1(b)).

On the basis of similar reasoning, transactions between group undertakings and in particular the resulting profits must not be taken into account (paragraph 1(c) and (d)). Group accounts may in principle only show as group profits those profits accruing from transactions between a group undertaking and a third party. Profits accruing from transactions between group undertakings may not be shown as profits gained at group level, and to do so would be incompatible with the aim of providing a true and fair view of the group's assets and liabilities and results.

Profits accruing from group undertakings must be entirely excluded. The Directive does not allow them to be excluded on a *pro rata* basis in proportion to the percentage of the capital held. The possible existence of shareholders outside the group does not alter the fact that profits accruing from undertakings within the group are unrealized.

Some leeway must be given, however, for the fact that it will not always be possible or easily practicable to exclude such profits totally, especially where fixed assets which have a limited useful life are concerned. When a transaction between group undertakings concerns such a fixed asset, the strict application of the principle of eliminating profits will mean that in future two different schemes for value adjustments would have to be carried out for this single asset, one within the framework of the balance sheet of the company in question and the other within the framework of the group accounts. Given the practical difficulties of such a solution, the Directive permits departures from this principle in this particular case, while specifically requiring that the relevant transactions must have been concluded under normal market conditions (paragraph 2(b)). In this way, action is taken in so far as is possible to limit the risk of abuse in the application of such a departure from the principle.

It is clear that group accounts cannot give the desired true and fair view unless the summary of its assets and liabilities, activities and results is based on the same financial year for all the group undertakings whose accounts are to be consolidated. The accounts of these undertakings whose accounts are to be consolidated. The accounts of these undertakings must therefore be drawn up as of the same date. It will not, however, always be possible in practice to draw up these accounts for exactly the same date, for example, where national law specifies a particular balance sheet date for certain kinds of undertaking or where any alteration in the balance sheet date would entail serious consequences with regard to taxation. The Directive therefore incorporates the principle that accounts should be drawn up on the same date, although it allows a degree of flexibility in applying it (paragraph 1(e)). However, should financial years not coincide, interim accounts are required which should be drawn up of the same date as the group accounts. This seems necessary to avoid a situation where group accounts include figures which refer to different periods and which are therefore meaningless. The exception clause in paragraph 2 allowing departures from the principle of elimination of profits has already been mentioned.

[1] Articles 14, 15, 17 and 18.
[2] See notes on Article 12 (2).
[3] Article 15.

The same paragraph also allows departures in exceptional cases from the principle of continuity. In addition to an adequate explanation of the reasons for such departures in the notes to the accounts, the Directive also requires an assessment of the effect on the group's assets, liabilities, financial position and results. Precise figures are not required under this provision, for to do so would be to rob the exception of much of its sense. It is sufficient to give an indication of its overall effects.

Article 15

Group accounts can give the desired true and fair view only where the items contained therein are valued on an identical or at least comparable basis. The Directive lays down three different principles in order to achieve this result.

It provides firstly that items included in the consolidation should in all cases be valued in accordance with the rules laid down in the fourth Directive (subparagraph(a)). No departures are permitted from this principle. What was considered essential in respect of the valuation of the assets and liabilities of individual companies must logically also apply in respect of the valuation of the group's assets and liabilities. Incidentally, this principle relates to the items to be consolidated and not to the annual accounts included in the consolidation. The latter may if necessary be drawn up on the basis of some other valuation system, for example, where some of the group undertakings are situated outside the Community or where certain undertakings are not subject to the provisions of the fourth Directive. In these instances, however, the values shown in these accounts must be corrected if necessary before being consolidated so that they accord with the valuation rules in the fourth Directive.

The fourth Directive allows different valuation methods and occasionally provides a choice of the way in which a specific method is implemented. It is therefore important to extend the above principle so that group undertakings whose accounts are included in the consolidation are required in principle to apply the same valuation rules in drawing up their annual accounts (subparagraph (b)). The aim of the Directive is to prevent group undertakings from publishing annual accounts which are drawn up on the basis of valuation rules other than those applied to the group accounts. A group undertaking might otherwise for example submit modest results in its annual accounts on the basis of which the distribution of profits will be decided, while bettter results are shown in the group accounts as a result of the use of a different valuation method.

A dominant group undertaking will easily be able to use its controlling position to ensure that the same system of valuation is used in practice throughout the group. Difficulties may arise, however, where a system is not permitted under national law or where its implementation would be prohibitive with regard to taxation. The Directive allows departures from the principle of a single system of valuation in exceptional circumstances in order to resolve such problems. Such departures may be made, however, only in drawing up the annual accounts of the undertakings concerned. Where those accounts are to be consolidated, the values shown will always have to be checked and corrected where appropriate in order that they comply with the valuation rules applied within the group.

Where the items included in the consolidation are valued in accordance with the rules contained in the fourth Directive and where in addition the annual accounts to be consolidated are drawn up in accordance with the same valuation rules, the values entered on the individual balance sheets must be entered on the group consolidated balance sheet (subparagraph (c)). This is the third principle relating to valuation in group accounts, stating the authority of the individual balance sheets with regard to the group accounts. However, this principle is subject to a number of exceptions stemming from the provisions of the Directive. It may thus be necessary to correct values entered on individual balance sheets in order to allocate consolidation differences,[1] to exclude claims, debts and profits arising within the group,[2] to carry out the special valuation of holdings referred to in Article 17, or to consolidate the accounts on a proportional basis as laid down in Article 18.

The Directive's final requirement as regards valuation is that deferred taxation should be taken into account. This is not a reference to deferred taxation which is taken into account in the annual accounts of the group undertakings and which is in any case included in the consolidation, but rather to the problem which can arise specifically with regard to group accounts. This provision applies to all those cases where a difference exists between the group results as shown in the group accounts and the results actually taxed at the level of group undertakings whose accounts have been consolidated. Such differences may have noticeable effects in the future with regard to taxation, which the Directive requires to be shown separately. Cases in particular in which the undistributed profits of a dependent group undertaking established outside the Community have been taxed on a scale much lower than that applicable to the dominant group undertaking come to mind. In so far as these profits will be distributed to the latter undertaking, account should be taken in advance in the group accounts of the effects of the distribution on the amount of tax to be paid.

Article 16

Article 12(1)(a) provides that consolidation differences must as far as possible be entered against the relevant items on the group consolidated balance sheet. Where such entries have

[1] Article 12 (1) (a).
[2] Article 14 (1) (b) and (d).

been made, the differences concerned disappear under the relevant items and are treated in the same way as those items as regards their valuation. The Directive invokes the provisions of the fourth Directive on this point.

Where the book value of a holding which is to be consolidated exceeds the corresponding percentage of the net assets of the undertaking in which the holding exists, and that difference cannot be entered against a specific item in the assets of that undertaking, the surplus amount paid by the undertaking acquiring the holding will normally be regarded as having been paid in respect of goodwill. These are the grounds for the provisions in the Directive that such items must be written off within five years in accordance with the rules already laid down in the fourth Directive in respect of goodwill acquired for valuable consideration.[1]

Article 17

The Directive introduces a special valuation method for group accounts in respect of holdings of group undertakings in the capital of undertakings which are associated with them. This means undertakings over which group undertakings exert a significant influence as defined in Article 1 of this Directive.

Where a significant influence is exerted, a special relationship is established between the group and its associated undertakings which must be taken into account when the relevant holdings are valued. Were valuation to be based merely on the purchase price, no account would be taken of the real effects of the significant influence exerted by the group and to that extent, any information given regarding the group's position would be distorted. It must be borne in mind that there is normally in practice some considerable lag between the time when profits accrue to an undertaking and the time when they are shown in the accounts of the undertaking with a holding in the former as resulting from dividends paid on the holding. Moreover, such an entry would provide no more than an incomplete indication of the profitability of the holding concerned.

This being so, a valuation method has been adopted in the Directive which indicates the results of the performance of associated undertakings as they concern the group's position in a more realistic light, and is thus more in line with the objective of giving the required true and fair view of the group's assets, liabilities, financial position and results.

Before describing this valuation method in further detail, it should firstly be recalled that the concept of associated undertakings also covers indirect relationships. In order to find out whether an undertaking is associated with a group undertaking, account must also be taken of the shares held by a dependent undertaking or a third party on behalf of a group undertaking. The method laid down in Article 17, however, covers only the valuation of a direct holding of a group undertaking in the capital of an associated undertaking.

The valuation method laid down in Article 17, which is already accountancy practice in several Member States, is similar in many ways to a consolidation in full. It is in fact a 'mini-consolidation'. The main difference is that the book value of the holding in the capital of the associated undertaking is not replaced in the group accounts by the asset and liability items on the balance sheet of that undertaking. On the contrary, this book value is used as a basis for certain corrections together with additional entries made in accordance with rules similar to those applicable to the consolidation in full.

Firstly, the purchase prices of the holding and the corresponding percentage of the net assets of the associated undertaking when such shares were acquired should be balanced. The difference must be shown as a separate item and its composition analysed. This process is essentially the same as the consolidation procedure laid down in Article 12(1)(a). However, the difference obtained in this particular instance is included in the book value of the holding and cannot be entered against the relevant items on the associated undertaking's balance sheet, since these are not incorporated into the group consolidated balance sheet ('one line consolidation').

Under Article 17, the analysis of this difference directly affects the valuation of the holding concerned. This valuation must take account of the origin of the items making up the difference referred to. This means that the values of those items must be corrected where appropriate under the valuation system applicable to them under the fourth Directive (paragraph 2(a)). Thus anyone reading the group accounts will gain a more realistic impression of the importance and value of these holdings.

The directive requires furthermore that valuation of a holding in the capital of an associated undertaking should take account each year of the associated undertaking's results (paragraph 2(b)). The purchase price of the holding must therefore be increased or reduced on the group consolidated balance sheet by a proportion, corresponding to the percentage of the capital held, of the profit or loss accruing to the associated undertaking. The amounts concerned must also be entered as a separate item in the group consolidated profit and loss account. These entries may refer only to results obtained by the associated undertaking after the holding in its capital was acquired. Anything preceding that date cannot be attributed to the group undertaking, previous results being moreover on of the factors determining the purchase price of the shares.

The corrections referred to above are carried out without reference to whether the associated undertaking is to distribute its profits or not. However, where a distribution of profits in the form of dividends will take place, the book value of the holding must be reduced accordingly, since the amount concerned will already have been shown as an asset on the group

[1] Article 34 (2) — Supplement 6/74 — Bull. EC.

consolidated balance sheet (paragraph 2(b)). Moreover, a distribution of dividends will not be reflected in the group consolidated profit and loss account for the same reasons.

There will not always be justification for incorporating the proportion of the result obtained by the associated undertaking in valuing the holding on the group consolidated balance sheet. In so far as this result stems from a transaction with a group undertaking, it cannot be regarded as having definitely accrued. The same reasons as those given in respect of consolidation in full militate in favour of excluding such internal transaction (paragraph 1(c)).

It must be reiterated here that valuation in accordance with Article 17 may be complicated by the fact that the associated undertaking draws up its accounts on a different date from that on which the group accounts are drawn up, or applied other valuation methods. The group undertaking will not normally be in a position to ensure on the mere basis of its significant influence that the associated undertaking conforms with the group's policy with regard to valuation or financial year. In these circumstances, the principle of the true and fair view laid down in Article 9 of this Directive requires that implementation of the method laid down in Article 17 must include full explanations in the notes to the group accounts to prevent anyone reading the group accounts from being misled.

The principle that undertakings of only minor importance may be disregarded should also apply in respect of the valuation method laid down in Article 17 (paragraph 3) as is the case with consolidation in full.[1]

Article 18

Accountancy practice in several Member States uses a special valuation method for group accounts in respect of holdings in undertakings managed jointly with one or several other undertakings which do not form part of the group (joint ventures). Using this method, asset and liability items and income and expenditure items contained in the annual accounts of an undertaking managed jointly are incorporated into the group accounts on a *pro rata* basis according to the percentage of the capital held by the group. This is in fact proportional consolidation, which, moreover, is carried out in accordance with the same principles as a consolidation in full.

This method can be justified on the ground that the group participates actively in the joint management of the undertaking concerned, and shares in the resulting profits. Proportional consolidation will be a better means of showing in the group accounts the economic realities of this relationship as regards both its content and the results produced. Full consolidation cannot be permitted in this case since an undertaking managed jointly with other undertakings which do not belong to the group cannot be regarded as being part of the economic unit which the group constitutes.

It was considered that the proportional consolidation method, which is well established in several Member States, ensures that a satisfactory amount of information is given and should for this reason be permitted. It is on these grounds that the Directive permits the Member States to provide for such a method in their national laws.

An undertaking managed jointly within the meaning of Article 18 will normally also be an associated undertaking falling within the scope of Article 17. It had therefore to be expressly laid down (paragraph 3) that Article 17 should not apply in respect of an undertaking whose accounts are consolidated on a proportional basis in accordance with Article 18.

Articles 19 to 24

The Directive contains provisions on the notes to the group accounts, the group annual report and the auditing and publication of the group accounts and the group annual report which are analogous to those laid down in the fourth Directive. Groups must fulfil the same obligations as individual companies in such matters.

It is important that group accounts clearly indicate the structure of the group. The Directive therefore requires that certain information (name, registered office, etc.) should be given regarding group undertakings, associated undertakings, undertakings whose accounts have been consolidated on a proportional basis, and finally, undertakings in which at least 10% of the capital is held by the group provided that they do not fall within the preceding categories.[2] The legal relationships between group undertakings in particular must be clarified. Such information serves particularly to throw some light on the legal means (e.g. control contracts) by which central and unified management is guaranteed in practice. Article 21 allows the above information to be omitted where it is likely to be seriously prejudicial to any of the undertakings concerned, as does Article 42 of the fourth Directive.

The fourth Directive[3] provides certain exemptions with regard to the auditing and publication of annual accounts for small 'sociétés à responsabilité limitée'. A similar set of rules is laid down in Article 23(2) and 24(2) of this Directive in respect of the auditing and publication of group accounts where the group meets the same criteria as to size as those laid down in the fourth Directive in respect of the 'société à responsabilité limitée' and where none of the group undertakings is a 'société anonyme' or a 'société en commandite par actions'.

[1] Article 10.
[2] Article 20 (2) and (5).
[3] Articles 49 and 50.

Section 4

Final provisions

Article 25

Where the group accounts are drawn up for the first time pursuant to this Directive after it has entered into force, any attempt to consolidate the accounts on the basis of the book value of a holding and the corresponding percentage of the net assets when the holding was acquired might prove unrealistic or even impossible. These basic figures will sometimes not be available when the accounts are to be consolidated. The Directive therefore contains a temporary solution whereby the date chosen for drawing up the first group accounts pursuant to this Directive should be regarded as a reference date for the consolidation.

Application of this transitional rule may mean that the book value when the first consolidation is to be carried out of a holding which is to be consolidated is considerably lower than the corresponding percentage of the net assets of the undertaking to be consolidated. This difference is to be regarded as forming part of the group's reserves.

Where the valuation method laid down in Article 17 is used for the first time pursuant to this Directive, certain problems such as those referred to above may also arise with regard to the analysis to be carried out pursuant to Article 17 (2)(a). This transitional solution should therefore also be extended to cover the application of this provision. The same applies in respect of the method of proportional consolidation according to Article 18.