Corporate Sector Accounting and Auditing in the EU Acquis Communautaire

3rd edition

CFRR
Centre for Financial Reporting Reform

WORLD BANK GROUP
Governance

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Preface

The first edition of the "Guide to Corporate Sector Accounting and Auditing in the EU **Acquis Communautaire**" (issued in 2007) was prepared by the World Bank with contributions from the European Commission and other relevant European institutions.

Henri Olivier, Professor at HEC-Management School of the University of Liège and former Secretary General of the Fédération Européenne des Experts-Comptables (FEE), updated the Guide as part of the second edition published in 2011. For this third edition Henri Olivier and Pascal Frerejacque (CFRR) revised the text with inputs from Andrei Busuioc and other CFRR colleagues and with the editorial assistance of Susan Schroeder and Ecaterina Gusarova, under the direction of Henri Fortin, Head of the CFRR.

The key elements of the **acquis communautaire** in the areas of corporate sector accounting and auditing are accessible at *http://ec.europa.eu/finance/accounting* and *http://ec.europa.eu/finance/auditing*.
Despite the extent and quality of the external assistance received in preparing the Guide, the CFRR is solely responsible for its contents.

Disclaimer

This Guide is intended to provide a general overview of the relevant sections of the **acquis communautaire** on financial reporting and auditing and does not attempt to give anything more than an introduction to the issues. It is not meant to be an exhaustive rendition of the law, nor is it legal advice to those reading it. The findings, interpretations, and conclusions expressed in this guide are entirely those of the authors. They do not necessarily represent the views of the World Bank, its Executive Directors, or the countries they represent.

About the CFRR

The Centre for Financial Reporting Reform (CFRR) located in Vienna, Austria, is part of the World Bank's Governance Global Practice and is responsible for the World Bank's corporate sector financial reporting activities in Europe and Central Asia. The Centre helps client countries build strong accounting, reporting, and auditing practices which bring sustainable and equitable private sector-led growth, strengthened governance and accountability.

The CFRR provides knowledge services including analytical and advisory services; learning and skill development; know-how and knowledge transfer; and technical assistance and institutional strengthening. Activities are focused on four areas of expertise: i) raising awareness of the importance of the corporate financial reporting reform agenda and contributing to legislative reform; ii) building institutional capacity by addressing knowledge gaps and offering tailored advice in areas such as public oversight and standards; iii) encouraging strong and engaged professional accountancy organizations; and iv) promoting the development of internationally compatible accounting education.

Detailed analysis of the extent to which accounting, reporting and audit systems comply with international good practice, and the capacity of institutions to implement and enforce such systems, have been completed in 29 countries. These "**Reports on the Observance of Standards and Codes on Accounting and Auditing (ROSC A&A)**" provide recommendations to national governments which are used to help develop and assess legislative reform and guide CFRR's engagement.

The CFRR also manages a range of regional and country-specific programs that seek to raise the quality of corporate financial reporting.

Regional programs include:
The Road to Europe: Program of Accounting Reform and Institutional Strengthening (EU-REPARIS), funded by the European Union as part of the Western Balkans Enterprise Development and Innovation Facility. EU-REPARIS supports candidates or potential candidates for EU enlargement in the countries of Southeast Europe to integrate more closely with the EU by aligning their legislative frameworks with the EU **acquis communautaire.**

The Financial Reporting Technical Assistance Program (FRTAP), funded by the Government of Switzerland through its "enlargement contribution". FRTAP supports newer EU member states, such as Poland, Latvia and the Czech Republic, to implement sustainable regulatory and institutional frameworks and achieve the correct implementation of the **acquis communautaire** in the area of financial reporting.

Strengthening Auditing and Reporting in the Countries of the Eastern Partnership (STAREP), funded by Austria, the EU, Luxembourg and Switzerland. STAREP works with the countries of the EU's Eastern Partnership to support the development of modern accounting and auditing frameworks, in line with international standards and taking account of EU requirements.

Country-level projects address a range of specific issues in client countries, including accountancy education in Moldova and the development of a reform strategy in Albania. The CFRR implemented or contributed to other projects to enhance corporate financial reporting practices including in Croatia, Macedonia, FYR Montenegro, and Serbia.

Introduction

We are pleased to present the third edition of “Corporate Sector Accounting and Auditing in the **Acquis Communautaire**”, designed to give an overview of EU policy in this area for policymakers, regulators, and other stakeholders in Member States, enlargement countries, countries within the “European Neighbourhood”, and other countries interested in understanding the EU regulatory model.

This edition reflects significant changes in EU corporate financial reporting since 2011. In June 2013, a new Accounting Directive was adopted, replacing the Fourth and Seventh Directives on company law. A Directive amending the 2006 Audit Directive and a new Audit Regulation addressing oversight of the most significant audits were adopted in April 2014.

The new legislation, summarized in this guide, is a result of several years of drafting and discussions following the financial crisis of 2008 and it represent a landmark in the EU’s efforts to strengthen its corporate sector accounting and auditing. The Accounting Directive seeks to enhance the quality of financial reporting and expand it, especially with regard to public interest entities, while reducing the administrative burden for smaller companies. The changes to the Audit Directive and the Audit Regulation are designed to increase or restore public confidence in audits, by strengthening mechanisms already provided in the 2006 Directive – especially quality assurance systems – and through a number of innovations such as mandatory rotation of audit firms or caps on non-audits services. The new audit reporting requirements introduced by the Regulation are expected to increase the usefulness of statutory audits of public-interest entities, such as listed companies, credit institutions, and insurance undertakings, and reduce risks of excessive familiarity between statutory auditors and their clients, encourage professional skepticism, and limit conflicts of interest.

The 2013 Accounting Directive must be transposed into national legislation by mid-July 2015, and the 2014 Auditing Directive must be transposed by mid-June 2016. A number of options are available to Member States regarding the Accounting Directive, including to adopt simpler requirements for smaller entities. The Audit Directive and the Regulation will bring more consistency in audit oversight and quality assurance systems across Europe. Implementation will involve significant challenges and require increased resources to ensure systems function effectively. The legislation puts a renewed emphasis on cooperation among public oversight authorities through a new European body. Cooperation between all key actors of public oversight and quality assurance at national level will also be important.

Now that the reform process initiated in 2010 with the Green paper on audit policy is complete a period of relative stability can be expected. A few outstanding issues remain. These include the effective adoption of the International Standards on Auditing in the EU; the process by which the International Financial Reporting Standards (IFRS) are adopted in the EU, which is currently under review; and the possible use by EU Member States of the IFRS for SMEs. At the international level, while achieving a common regulatory framework for accounting and auditing remains an elusive goal, there is continued convergence in both areas, and countries will continue to benefit from the EU experience.

Henri Fortin
Head, Centre for Financial Reporting Reform – World Bank
March 2015

1. Overview of the European Union

1. A number of treaties provide the fundamental basis of the European Union (EU). The EU's origins can be traced to the Treaty establishing the European Coal and Steel Community (ECSC), also referred to as the Treaty of Paris, which came into force in 1952.[1] The ECSC's original objective was to "lead to the realization of the first concrete foundation of a European Federation indispensable to the preservation of peace" following the two World Wars.[2] In addition to this underlying motive, the ECSC rested primarily upon the ideas of economic growth, free market competition, and the improvement of living standards. The initial success achieved by ECSC cooperation led to successive treaties, which in turn created the institutional bodies and the body of EU laws known collectively as the **acquis communautaire** (see paragraph 12). Each successive treaty (or treaty revision) and change to the **acquis communautaire** has aimed at bringing the Member States closer together economically, socially, and politically in order to promote the region stability and economic growth.

2. This section begins with an overview of the main treaties establishing the EU. It then looks at the current state of EU membership and its various policies towards its neighbor countries, particularly as regards accession. This section then examines the **acquis communautaire** and the legislative means by which it is developed, as well as its application in practice. Finally, this section turns to the institutions established by the treaties and the policy-making process through which these institutions interact.

A. THE MAIN TREATIES[3]

3. Following the Treaty of Paris, the Treaty of Rome (commonly referred to as the "EC Treaty") entered into force on 1 January 1958, creating the European Economic Community (EEC). The EC Treaty laid down the framework for bringing about a common market and developing a number of common policies. It contained from the outset a legal basis for company law harmonization. At that time, the role of the European Parliament in the law-making process was only advisory (the so-called "consultation procedure" see paragraph 26).

1 For more detail on the ECSC, see *http://europa.eu/legislation_summaries/institutional_affairs/treaties/treaties_ecsc_en.htm.*

2 French Minister of Foreign Affairs Robert Schuman's speech on May 9, 1950. For full text, see *http://europa.eu/abc/symbols/9-may/decl_en.htm.*

3 See *http://europa.eu/abc/treaties/index_en.htm.*

4. However, once these initial moves towards greater community integration had been completed, the process lost momentum by the early 1980s. Amidst mounting political criticism, the EEC's political leaders decided to move forward by passing the Single European Act (SEA), which entered into force on 1 July 1987. The SEA adapted the Treaty of Rome in order to hasten the completion of the Internal Market by 31 December 1992. It introduced a new legal basis for harmonization of laws in order to establish the Internal Market, and a new legislative procedure (the so-called "cooperation procedure," see paragraph 27).

5. The Treaty on the European Union, also referred to as the Maastricht Treaty, entered into force on 1 November 1993, and was built on the integration successes of the SEA. It changed the name of the European Economic Community to "the European Community" and introduced detailed provisions on the creation of an economic and monetary union. It also introduced a new legislative procedure (the so-called "codecision procedure," see paragraph 28) as well as the principle of subsidiarity (see paragraph 16).

6. The Treaty of Amsterdam, which entered into force on 1 May 1999, amended and renumbered the previous Treaties. It strengthened the role of the European Parliament and extended the scope of the co-decision procedure's application.

7. In anticipation of the addition of ten new Member States, the Treaty of Nice entered into force on 1 February 2003. The treaty reformed institutions to enable the EU to function efficiently after its enlargement to 25 Member States.

8. The Treaty establishing a Constitution for Europe was signed in Rome on 29 October 2004. The intention of this document was to replace the existing treaties with a single text and to bring about a large number of institutional changes aimed at increasing the efficiency and democratic legitimacy of EU decision-making. Negative referenda in France and the Netherlands meant that the Treaty failed to be ratified by all Member States.

9. Subsequently on 13 December 2007, EU leaders signed the Treaty of Lisbon, which was designed to bring an end to years of negotiations on institutional issues and "to complete the process started by the Treaty of Amsterdam and by the Treaty of Nice with a view to enhancing the efficiency and democratic legitimacy of the EU and to improving the coherence of its action." It includes an important overhaul of the Maastricht Treaty and the Treaty of Rome including a proposal that the EU will take on a single legal personality, strengthening the role of the European Parliament and extending the co-decision making process.[4] After some political turbulence, the Treaty of Lisbon was ratified by all 27 Member States and entered into force on 1 December 2009. A coordinated version of the Treaty on the functioning of the European Union (TFEU) was published in the Official Journal of the European Union on 9 May 2008.[5]

4 Egenhofer, C. Kurpas, S. van Schaik, L. (2009), "The Ever-Changing Union. An Introduction to the History, Institutions and decision making Processes of the European Union" *Centre for European Policy Studies,* Special Report, January 2009

5 OJ-EU C 306, 17 December 2007; See *http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=OJ:C:2007:306:TOC*

B. MEMBER STATES, ACCESSION AND THE EUROPEAN NEIGHBOURHOOD POLICY

10. The EU currently comprises 28 Member States. In 1958, the Treaty of Rome created a common market and customs union, and provided for the free movement of capital and labor among the six signatories: Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Additional Member States were added to the EU through seven enlargements (see Annex: Timeline). The most recent member, Croatia, joined the EU on 1 July 2013.

11. Turkey started accession negotiations in October 2005. In December 2005, the European Council granted the former Yugoslav Republic of Macedonia the status of a candidate country. In December 2010 Montenegro and Iceland were also granted the same status. In line with the decision of the European Council in June 2013 to open accession negotiations with Serbia, the Council adopted the negotiating framework in December 2013. All the other Western Balkan economies are potential candidates: Albania, Bosnia and Herzegovina and Kosovo. The EU has repeatedly reaffirmed at the highest level its commitment to eventual EU membership of the Western Balkan countries, provided they fulfill the accession criteria. There are several associative frameworks that extend EU relationships throughout its geographic region. Norway, Iceland and Liechtenstein are members of the "European Economic Area" (EEA) and therefore have access to the EU single market; however, they are not allowed to participate in the EU decision-making process. Following a referendum in 1992, Switzerland rejected EEA membership; however it enjoys privileged relations with the EU Internal Market through a number of bilateral agreements. In addition, the EU has Association and/or Partnership and Cooperation Agreements[6] with many other countries. Through its European Neighbourhood Policy (ENP),[7] the EU works with its southern and eastern neighbors to achieve the closest possible political association and the greatest possible degree of economic integration. The ENP is complemented by regional and multilateral agreements such as the Eastern Partnership, the Black Sea Synergy or the Euro-Mediterranean Partnership. For instance, the Eastern Partnership (EaP), launched in 2009, enables partner countries interested in moving towards the EU and increasing political, economic and cultural links to do so.[8] The EU is not offering ENP countries/entities the possibility of membership, at least for the time being. As is obvious from the large number of associative relationships, the sphere of influence of the EU's institutions and of the **acquis communautaire** therefore extend far beyond the actual EU Member States' borders.

6 These agreements are signed bilaterally and each agreement sets forth a different set of objectives. Some agreements focus on economic dialogue, political dialogue, and/or trade liberalization, among other themes, while others are precursors to an accession treaty.

7 The European Neighbourhood Policy applies to the EU's immediate neighbours by land or sea, i. e. Algeria, Armenia, Azerbaijan, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, Moldova, Morocco, Russian Federation, Syria, Tunisia, Ukraine, and West Bank & Gaza. Although Russia is also a neighbor of the EU, the EU's relations with Russia are instead developed through a "Strategic Partnership."

8 See *http://eeas.europa.eu/world/enp/index_en.htm.*

C. THE ACQUIS COMMUNAUTAIRE

12. The entire body of EU laws is known collectively as the **acquis communautaire** (the "**acquis**"). The term is most often used in connection with preparation by candidate countries to join the EU. Within the context of EU accession, a country must meet certain criteria, among which is the adoption of the **acquis**. All Member States must comply with the **acquis** unless they have negotiated an opt-out. Although new Member States may be granted transition periods for implementation, they will not be granted permanent 'opt-outs'. For recent enlargement negotiations, the **acquis** has been divided into 35 chapters. Chapter 6 (Company Law) has greatest relevance to corporate sector accounting and auditing; Chapters 2 (Freedom of Movement for Workers) and 3 (Right of Establishment and Freedom to Provide Services), Chapter 4 (Free Movement of Capital), Chapter 8 (Competition Policy), and Chapter 9 (Financial Services) also have some implications. When applying for membership, an applicant country will receive a roadmap from the European Commission tracing its progress in adopting the **acquis**. Accession negotiations may be concluded even if the **acquis** has not been fully adopted, as transitional measures may be introduced after accession. However, transposition periods and specific transitional measures are rarely applied in the context of Chapter 6.

13. Each Association Agreement/Partnership and Cooperation Agreement sets out a different agenda for approximation to parts of the **acquis** although generally there are no deadlines. Association Agreements with Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, Moldova, Morocco, Syria, Tunisia, Ukraine, and West Bank & Gaza have entered into force. As the EU does not offer the incentive of membership to these countries in exchange for aligning their legislation with the **acquis**, ENP countries/entities may not be as keen on adapting to the **acquis** as accession countries. However, the incentives on offer, in return for progress on relevant reforms, are greater integration into European programs and networks, increased assistance and enhanced market access. Building on the experience acquired from the implementation of the Neighbourhood Programs in the period 2004 to 2006, the EU adopted a framework for Neighbourhood and Partnership Instruments to provide Community assistance for the development of an area of prosperity and good neighbourliness involving the European Union, and its neighbours.[9]

14. The **acquis** includes all primary legislation (Treaties), secondary legislation (regulations, directives, decisions, recommendations, etc...) and case law (judgments of the European Courts). As EU legislation is constantly changing (e.g., new directives are enacted, regulations are amended), the **acquis** is not a static document, but one that is in constant evolution.

9 Regulation 1638/2006/EC of 24 October 2006, laying down general provisions establishing a European Neighbourhood and Partnership Instrument. (OJ EU. L310 9.11.2006)

i. Main legislative instruments

15. Article 288 of the TFEU states that "to exercise the Union's competences, the institutions shall adopt regulations, directives, decisions, recommendations and opinions". The ordinary legislative procedure consists in the joint adoption of a regulation, a directive or a decision by the European Parliament and the Council, on a proposal of the Commission (Art. 289 TFEU): [10]

- **Regulations** are addressed to and directly applicable and binding in all EU Member States without the need for any national implementing legislation.[11] Regulations are the type of legislation that most closely resemble a domestic statute and are used when uniformity is crucial.
- **Directives** are binding with respect to the results to be achieved and the time limit within which the objectives must be reached; however, they leave to national authorities the choice of form and means for achieving those results. Directives have to be transposed into national legislation in accordance with the procedures of the individual Member States and by a fixed date. The deadline for Member States to transpose a directive into national law is generally between 18 to 24 months after its publication. Directives are the most frequently used instrument in relation with the establishment of the internal market (Art. 50 TFEU).
- **Decisions** are binding in all their aspects for those to whom they are addressed. Decisions do not require national implementing legislation. A Decision may be addressed to any or all Member States, to enterprises or to individuals.
- **Recommendations, Opinions, Interpretative Communications, and Commission Comments** are non-binding and are considered "soft law." Soft law can be defined as "rules of conduct, which in principle have no legally binding force but which nevertheless may have practical effects."[12] As such they promote good practice throughout the EU. Soft law is often the starting point for the "Communitarisation" of a particular policy area, acting as the precursor to the development of hard law.[13]

ii. Main legislative principles

16. A number of main legislative principles govern the way the EU formulates and implements public policy, and how these policies affect the national legislation of individual Member States. The first of these is the principle of **subsidiarity**, introduced by the Maastricht Treaty. According to this principle, in areas which do not fall within its exclusive competence, the EU may act only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States but can rather, by reason of the scale or effects of the proposed action, be better achieved

10 Although the legal acts did not change, the Lisbon Treaty substantially modified the procedure to adopt these legal acts. Consolidated versions of the Treaty on European Union and the Treaty on the functioning of the European Union (OJ EU C115, 9.5.2008). See *http://europa.eu/lisbon_treaty/full_text/index_en.htm.*

11 However in practice national legislation often has to be changed or removed in order to comply with Regulations.

12 SNYDER, F. (1993), "The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques."

13 CHALMERS D. (1998), "European Union Law, Volume I: Law and EU Government," Dartmouth Pub., Aldershot, UK

at EU level. This is intended to ensure that decisions are taken as closely as possible to the citizen in order to avoid too much centralization of power. Other principles include the principle of **proportionality,** which requires that any Community action should not go beyond what is necessary to achieve the objectives of the treaty.

17. Before the Lisbon Treaty, EU legislative measures provided for the European Commission to be assisted by committees in accordance with the "comitology decision" (Decision of 28 June 1999 modified on 17 July 2006). The committees consist of representatives from Member States and are chaired by the Commission. The Commission can only adopt implementing measures if it obtains the approval by the Member States meeting within the committee and absent objections from the European Parliament. Examples include the Accounting Regulatory Committee and the Audit Regulatory Committee.

18. Since the Lisbon Treaty, a new legal framework replaces the comitology. The Treaty formally distinguishes between two kinds of measures: delegated acts (based on Art. 290 TFEU) and implementing acts (based on Art. 291 TFEU). Article 290 TFEU makes the Commission solely responsible for drafting and adopting delegated acts although the European Parliament and the Council have an ex-post right of control; they can oppose or revoke the delegation.

19. Where uniform conditions for implementing legally binding Union acts are needed, those acts shall confer implementing powers on the Commission (Article 291 TFEU). The rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers have been laid down by a Regulation of the European Parliament and the Council of 16 February 2011 (EU/182/2011).[14] Implementing acts will easily be identified since the Treaty requires that the word 'implementing' be inserted in the title of these acts.

20. The new "examination procedure" confirms that, in order to prepare an implementing act, the Commission shall be assisted by a committee composed of representatives of the Member States where opinions will be delivered with a weighted majority. The committee shall be chaired by a representative of the Commission who shall not take part in the committee vote. If the committee does not reach a conclusion or when its opinion is negative, the Regulation provides for a possible appeal mechanism by the European Commission. Where a basic act is adopted under the ordinary legislative procedure, either the European Parliament or the Council may at any time indicate to the Commission that, in its view, a draft implementing act exceeds the implementing powers provided for in the basic act. In such a case, the Commission shall review the draft or withdraw the draft implementing act.

[14] Regulation EU/182/2011 of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers. OJ EU L 55 of 28 February 2011

D. EU INSTITUTIONS & THE EU POLICY-MAKING PROCESS

i. The primary EU Institutions[15]

21. At the core of the EU there are seven main institutions, each playing a specific role: the European Commission, the European Parliament, the European Council, the Council of Ministers of the European Union, the European Court of Justice (ECJ), the Court of Auditors and the European Central Bank. The European Commission (the "Commission") is the driving force and executive body of the EU playing a central role in the European decision making process.[16] As such, it is responsible for the proposal of any new legislation to the European Parliament and Council. Additionally, it manages and implements the EU's policies and budget, "enforce[s] European law (jointly with the ECJ) [and]…represent[s] the EU on the international stage, for example by negotiating agreements between the EU and other countries."[17] The Commission is composed of Commissioners who are in charge of Directorates General (DG), or institutionalized policy area. Each DG and its staff are managed by a Director General. The Directorates General are broken down into policy sub-units called Directorates, which are further broken down into more specific Units. The entire European Commission is meant to function above the level of national interests.

22. In contrast to the supranational EU-level focus of the Commission, the European Council and the Council of Ministers of the European Union (the "Council") directly represents the Member States. They consist respectively of Head of States or Government[18] and of Member States' Ministers in different configurations depending on the subjects under discussion. Each country has a number of votes in the Council broadly reflecting the size of its population, but weighted in favor of smaller countries. The Council shares with Parliament the responsibility for passing EU laws.[19] Once the Commission issues a proposal, the Council is responsible for either approving or rejecting the proposal. The Member States hold the Presidency of the Council on a six-month rotational basis. The subject at hand in the Council determines which Member State ministers attend a Council meeting. The Council is administered by a General Secretariat which briefs the Presidency, helps prepare the agenda, and reports on progress. The Committee of Permanent Representatives (COREPER) is the Council's key committee, in which the permanent representatives of all EU Member

15 See *http://europa.eu/abc/panorama/howorganised/index_en.htm* for a more comprehensive description of how the EU is organized.

16 The Commission has five basic functions: the right and duty of initiating Community action and legislation; the guardian of the Treaties; the responsibility for the implementation of Community decisions; the decision-making authority in the field of competition policy; and the external representation of the European Community. Egenhofer, C, Kurpas, S, van Schaik, L. op cit (2009)

17 See *http://europa.eu/institutions/inst/comm/index_en.htm*

18 The wording "European Council" refers solely to the meeting of the Heads of State and Government from the respective Member States. It has a permanent President and the President of the Commission also attends the meetings. The European Council provides the Union with the necessary impetus for its development and defines the general political directions and priorities thereof. It does not exercise legislative functions, which is the responsibility of the Council of the European Union. Further details on the different configurations of this institution can be found at: *http://www.consilium.europa.eu/showPage.asp?id=429&lang=en&mode=g*

19 It is also in charge of the EU's foreign, security and defense policies, and is responsible for key decisions on justice and freedom issues.

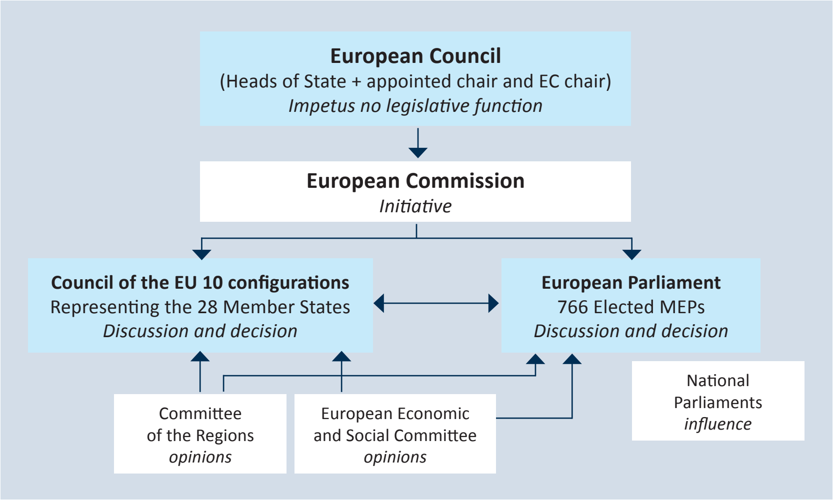
States sit and prepare the formal Council meetings by trying to secure political agreement among the Member States.

23. The Members of the European Parliament (MEPs) are directly elected every five years and represent the citizens of the EU. There are 766 Members representing all 28 EU Member States. The main function of Parliament is to pass European laws on the basis of proposals presented by the European Commission. Parliament shares this responsibility with the Council of the European Union. Over time, the European Parliament's role in approving legislation along with the Council has increased. Twenty two standing committees exist within Parliament. The Committee on Economic and Monetary Affairs (ECON) and the Legal Affairs Committee (IURI) share responsibilities on the regulation and supervision of financial services, institutions and markets including financial reporting, auditing, accounting rules, corporate governance and other company law matters specifically concerning financial services. With regard to EU law-making procedures, the Parliament is included in decisions via three processes detailed hereafter (see paragraphs 26 to 28). It is also worth noting that the Economic and Social Council representing the social partners (business, workers and civil society) and the Committee of the Regions issue opinions on legislative proposals, which are addressed to the three legislative institutions.

24. The ECJ ensures that EU laws are enforced by Member States and are coherently interpreted and applied uniformly across the EU. In addition, the ECJ plays a pivotal role of "referee" between the EU and its Member States, as well as between the EU's own institutions.

25. Over time and with the passing of successive treaty reforms, the distribution of powers of these institutions has and continues to shift, particularly as regards the Commission, the Council and Parliament. Successive EU founding treaties set forth three main procedures (described in paragraphs 26 to 28) under which these institutions make and/or implement EU policy. A distinctive feature of each procedure is the degree of influence of the Parliament. Consultation grants the least amount of influence to Parliament; cooperation increases the powers of Parliament, and ordinary legislative procedure grants the most power to Parliament in the policy-making process.

Graphic 1: EU law-making process



ii. The law-making process

26. The consultation procedure was the legislative procedure originally provided for under the Treaty of Rome. It obliges the Council to consult the European Parliament before voting on a Commission proposal. However, Parliament's opinion is not binding on the Council. Until 1987 this procedure applied to the harmonization of company and accounting law. The Fourth and Seventh EU Company Law Directives on annual and consolidated accounts were adopted on the basis of this procedure.

27. The cooperation procedure was introduced by the SEA. It gives the European Parliament greater influence in the legislative process, by allowing it two "readings." The scope of this procedure was considerably extended by the Maastricht Treaty (see paragraph 5); however, the Treaty of Amsterdam (see paragraph 6) reversed this by introducing the co-decision procedure. Since then, the cooperation procedure applies exclusively to the field of economic and monetary union.

28. The Treaty of Lisbon (see paragraph 9) expands this further. The co-decision renamed as "ordinary legislative procedure" places the European Parliament and the Council of Ministers on an equal footing (i.e., no institution may adopt legislation without the other's assent and both institutions have the power to reject legislation). The procedure allows adoption of legislative proposals in one or two readings or eventually after a conciliation procedure.[20] The ordinary legislative procedure to adopt regulations or directives is the core legislative procedure for the purpose of EU law-making in the areas of company law, including accounting and auditing.

[20] See *http://ec.europa.eu/codecision/procedure/index_en.htm.*

iii. EU Institutions primarily responsible for Corporate Sector Accounting and Auditing

29. Until November 2014, the Directorate General for Internal Market and Services (DG MARKT) was one of the 44 Directorates General and other specialized services which make up the European Commission (see paragraph 21). Its main role was to coordinate the Commission's policy on the European Single Market, which aims to ensure ever greater European market integration and the free movement of people, goods, services and capital within the EU.[21] In that context, the DG Internal Market and Services was responsible for policies and regulations concerning financial services, company law, financial reporting, professional qualifications, free movement of services, and freedom of establishment.

30. The allocation of portfolios and support services to the members of the new European Commission, which entered into office in November 2014, modified the administrative organization of the EC. A new Directorate General has been created to deal with "Financial Stability, Financial Services and Capital Market Union". This new DG takes over part of the responsibilities of the previous DG MARKT; in particular financial reporting by companies in the private sector and statutory audit. Some other services directly related to internal market policy, for instance free movement of professionals throughout the EU, are merged with another Directorate General, DG Enterprise, which plays already an important role in enhancing the Internal Market by developing policies, laws and regulations for specific industries and SMEs. This DG is now renamed "Internal Market, Industry, Entrepreneurship and SMEs". It is also relevant to note that harmonization of company law becomes a competence of the DG Justice.

31. The European Parliament has two committees that address the topics of company law, accounting and auditing. The first is the Committee on Economic and Monetary Affairs. The second committee is the Committee on Legal Affairs.

21 See *http://ec.europa.eu/finance/accounting/index_en.htm.*

2. The Internal Market

A. BACKGROUND OF THE EU INTERNAL MARKET

32. One of the main objectives of the Treaty of Rome was the creation of a single common market, with free movement of goods, persons, services and capital, to accelerate improvements in standards of living. Although a customs union was established from 1 July 1968, the integration process slowed considerably through the early 1980s. In June 1985, the Commission adopted the **White Paper on the Completion of the Internal Market** to revive the European market integration effort. This paper set out an ambitious program (the "Europe 1992" program) to create a truly effective internal market by the end of 1992.

33. In 1987, the Single European Act introduced the notion of an "internal market" into the existing Articles of the Treaty of Rome, now used interchangeably with the original expression, "common market ." Although both concepts refer to market integration and the elimination of all obstacles to intra-Community trade throughout the EU, the "Internal Market" is seen as a more fully integrated evolution of the "common market". The Single European Act introduced a new provision (Article 95) that empowers the Council to adopt, by a qualified majority vote, measures regarding the establishment and functioning of the Internal Market. In addition, a new policy in the area of harmonization emerged, shifting the Commission's previous aim of comprehensive harmonization of laws, including in the area of company law, to a reduced approach, based on the subsidiarity principle, focusing on the harmonization of only those laws and policies deemed to be essential.

34. Although the "Europe 1992" project resulted in the adoption of most of the 282 Internal Market Directives from the 1985 White Paper by 1 January 1993, a number of significant measures were still missing. In addition, serious problems existed with the transposition within individual Member States. The Commission therefore issued in 1996 a Communication on **The Impact and Effectiveness of the Single Market**[22] to renew attention on the Internal Market project: it highlighted the gaps in the current framework, the absence of competition in a number of sectors and the continuing existence of barriers to trade resulting from a variety of national rules. It underlined the need for concerted action in the areas of company law and financial services. Since then, significant progress in deepening the integration of the Internal Market has been achieved. Approaching the 20th anniversary of the symbolic date of 1992, Professor Mario Monti was asked by the President of the Commission to

22 See *http://ec.europa.eu/internal_market/economic-reports/docs/single_en.pdf.*

prepare a report containing options and recommendations for the future of the internal market. This report entitled, “A New Strategy for the Single Market” was tabled on 9 May 2010 proposing a new set of initiatives to deliver a stronger single market in Europe. Fifty proposals were selected by the Commission as priorities in the Communication of October 2010 “Towards a Single Market Act”.[23] Commissioner Michel Barnier and the European Commission intend to keep the Single Market Act high on the political agenda. The following section describes in more detail the strategies of the internal market.

B. THE INTERNAL MARKET STRATEGIES

35. The EU has launched a number of strategies and action plans to increase efforts toward the completion of the Internal Market. The European Council’s 1997 Action Plan for the Single Market[24] stressed the need to (a) promote greater competitiveness of European capital markets as a means for attracting trade and investment, as well as (b) make European companies more attractive in international capital markets. These two goals would be achieved through greater intra-EU legislation harmonization, and by harmonizing EU accounting rules with internationally accepted accounting standards. Within the Commission’s subsequent 1999 Strategy for Europe’s Internal Market, four strategic objectives were outlined:

- to improve the quality of life of citizens,
- to enhance the efficiency of Community product and capital markets,
- to improve the business environment, and
- to exploit the achievements of the Internal Market in a changing world.

36. These objectives continue to be valid today.

37. Each of these strategic objectives was accompanied by a number of operational objectives, which were intended not only to contribute to the achievement of the Strategy’s goals but also to act as a benchmark for the progress of the Strategy. Those relevant to company law, including accounting and audit, are:

- the Financial Services Action Plan (1999)[25] followed by the Lamfalussy Report (2001)[26] proposing institutional measures to accelerate the implementation of the FSAP’s objectives;
- the Lisbon Strategy (2000);[27]
- the Winter Report (2002)[28] followed by the Company Law Action Plan (2003);[29]

23 Doc COM(2010) 608 final/2;
See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0608:REV1:EN:PDF#page=2*

24 See *http://europa.eu/legislation_summaries/other/l70002_en.htm.*

25 See *http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf.*

26 See *http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf.*

27 See *http://ec.europa.eu/growthandjobs/pdf/lisbon_en.pdf.*

28 See *http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf.*

29 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52003DC0284:EN:HTML.*

- the White Paper on Financial Services Policy (2005–2010) (2005);[30]
- the Monti Report: A New Strategy for the Internal Market (May 2010)[31] and
- The Single Market Acts (I and II) (April 2011 and October 2012)[32]

38. The corporate scandals and financial turbulence in the first decade of the century reemphasized the importance of ensuring high-quality financial reporting and enforcement through an updated Internal Market Strategy in the area of financial services. Based on the Report on Financial Supervision in the EU presented by the High-level Group chaired by Jacques de Larosière,[33] a legislative package to strengthen financial supervision in Europe was approved in September 2010, including the creation of a European System of Financial Supervisors with three new European Supervisory Authorities. The approval of these proposals changes substantially the financial services architecture (see paragraphs 46–49).

39. One priority of the Internal Market Strategy is the integration of services markets, which is of particular relevance to corporate sector accounting and auditing. In the field of services, there are still considerable differences between Member States, which is a barrier to the free movement of services. This barrier affects all stages of the business process and can deter companies from operating in other Member States.

40. The European Commission's first report on the implementation of the Internal Market Strategy Priorities for 2003–2006 found that too many European industries, including accounting services, still operate in fragmented markets due to trade obstacles and differences in standards and regulations. Fragmented markets hamper innovation and productivity growth and keep prices in some parts of the EU at higher levels than they would be in a more integrated Internal Market. Although the Internal Market has boosted EU economic growth and created jobs over the past ten years, much still needs to be done to build on that success. The European Commission's second report on the implementation of the Internal Market Strategy 2003–2006[34] pointed to the need for a stronger focus on completing the legal framework of the Internal Market, ensuring greater coherence and synergy with other EU policies and thus ensuring that the Internal Market legal framework is better attuned to the global economic framework.

41. The market turmoil at the end of the first decade of the XXI^st^ Century re-emphasized the need to continue to improve framework conditions for business, particularly for small and medium sized businesses that in contrast to large companies often find the single market fragmented and difficult to penetrate. DG MARKT focused on two main objectives: an integrated and well-functioning Single Market and a properly supervised, stable, efficient financial system. To reach these goals specific objectives are formulated as follows in the DG's Annual Management Plan 2014,[35] including:

30 See *http://ec.europa.eu/internal_market/finances/policy/index_en.htm*
31 See *http://ec.europa.eu/internal_market/strategy/docs/monti_report_final_10_05_2010_en.pdf*
32 See *http://ec.europa.eu/internal_market/smact/index_en.htm*
33 See *http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf*
34 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0011:FIN:EN:PDF.*
35 See *http://ec.europa.eu/dgs/internal_market/docs/management-plan_en.pdf*

- The EU's regulatory framework for Services fosters growth and jobs, including through mobility in the EU, and supports delivery of quality services for all consumers at affordable prices, regardless of the technology used in their delivery;
- EU businesses benefit from a regulatory level playing field and consistent market access at international level;
- EU companies can operate and move easily within the EU, are well governed and transparent, present high quality and comparable financial reports and are subject to high quality audits and ratings;
- Free movement of capital is applied in a coherent way in the EU, enabling access for European companies and States to capital and ensuring the integrity of financial markets;
- Appropriate supervision, robust market infrastructures and a high level of transparency contribute to the stability and integrity in financial markets;
- Effective investor protection is ensured through strict conduct-of business and disclosure rules;
- Banking, insurance and pension sectors are stable, resilient and at the service of the real economy due to prudential and supervisory measures as well as to a resolution regime.

C. FINANCIAL SERVICES REGULATION AND SUPERVISION

42. One of the key operational objectives to be achieved by the Strategy for Europe's Internal Market was the implementation of the Financial Services Action Plan (FSAP). EU policymakers viewed the integration of financial services as crucial following the introduction of the single currency, as this sector acted as "the motor for [economic] growth and job creation." The FSAP contained some forty measures aimed at achieving an integrated market for financial services in the EU. It set out indicative priorities and a timetable for specific measures to achieve three strategic objectives: establishing a single market in wholesale financial services; making retail markets open and secure; and strengthening the rules on prudential supervision.

43. Upon the completion of the regulatory aspect of FSAP, the Commission concluded that the EU financial services industry (banking, insurance, securities, asset management) still had strong untapped economic and employment growth potential and issued a White Paper in December 2005, entitled "Financial Services Policy 2005–2010" detailing the subsequent implementation phase of the FSAP. The policy explores the best ways to deliver effectively further benefits of financial integration to industry and consumers alike. Priorities include ensuring sound implementation and enforcement of existing rules; driving through better regulation principles into all policy making; enhancing supervisory convergence; creating more competition between service providers and the expansion of EU's external influence in globalizing capital markets.

44. A number of other EU initiatives complemented the FSAP. In 2000, the European Council reaffirmed the need to achieve Community financial market integration, calling for the acceleration and completion of the FSAP by 2005. These initiatives in-

cluded the Company Law Action Plan (CLAP) and the Commission's Communication, **Internal Market Strategy-Priorities 2003–2006** (see paragraph 52). The Communication drew upon previous Internal Market Strategies and aimed at strengthening the Internal Market in the face of its enlargement. Of the numerous goals that this Communication prioritized, the two most urgent were the implementation of outstanding FSAP legislation and the development and implementation of "better governance." Priorities were revised to the following: (a) completing the legislative reforms as laid out in FSAP in 1999, (b) improving corporate governance and (c) harmonizing company law.

45. A difficult problem in EU law-making results from the length of the procedure, especially when working with directives to be transposed in national legislations. This seemed to be especially harmful in the areas covered by the Financial Services Action Plan. In 2001, a Committee of Wise Men on the Regulation of European Securities Markets produced the **Lamfalussy Report**. This report sets out a transparent process of policymaking and laid down a regulatory approach involving different levels of measures and bodies[36] in what has come to be known as the **Lamfalussy Process**. The first level involves using the co-decision process with the Council and Parliament to reach an agreement on the broad principles contained in the legislation. The second level subsequently enhances the broad principles by adding measures for the actual implementation of the first level legislation. These first two levels aim to promote greater transparency in the overall legislative process as well as greater consultation with stakeholders in the process. The next two levels of the Lamfalussy process, Levels 3 and 4, are respectively the coordination of Member States' implementation efforts in an advisory capacity and the proper enforcement of the Lamfalussy measures across the EU. The Lamfalussy process overall has been praised for facilitating the speed at which political agreement is reached on financial markets legislation. Most notably, the process has been credited as a success for the timely delivery of the Market Abuse Directive (2002), the Prospectus Directive (2003), the Market in Financial Instruments Directive (2004), and the Transparency Directive (2004).[37]

46. Following the review of the Lamfalussy process carried out in 2007 by the Commission, the Inter-Institutional Monitoring Group and the Council, the Commission initiated a range of actions with a view to strengthening the Lamfalussy process, and in particular, cooperation between supervisors and convergence in their practices. These included, amongst others, a review of national supervisory and sanctioning powers; of voluntary delegation of tasks; of provisions on supervisory cooperation and exchange of information; and of consistency of terminology in EU financial services directives. However, the financial turmoil in 2007–2009 revealed deeper weaknesses in the system and the need to further strengthen existing mecha-

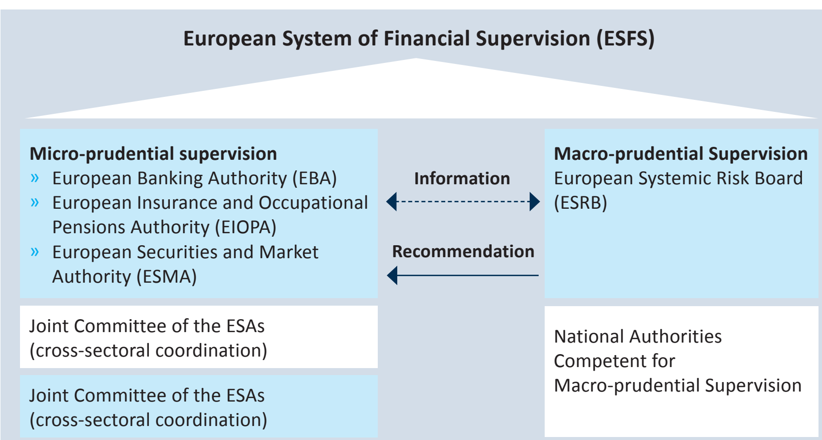
36 Examples of these bodies were the European Securities Committee (ESC), the Committee of European Securities Regulators (CESR), the European Banking Committee (EBC), the Committee of European Banking Supervisors (CEBS), the European Insurance and Occupational Pension Committee (EIOPC), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), the Accounting Regulatory Committee (ARC), the Audit Regulatory Committee (AuRC) and the European Group of Auditors' Oversight Bodies (EGAOB).

37 See *http://ec.europa.eu/internal_market/securities/docs/lamfalussy/sec-2004-1459_en.pdf.*

nisms and institutions in order to better deal with cross-border and systemic cases. Appropriate regulatory responses were necessary to prevent repetition of major financial systemic crises. The foundations of the new structure were defined in a report prepared under leadership of former IMF Chairman Jacques de Larosière, and issued in February 2009.[38]

47. This report analyzed the financial crisis in order to determine the appropriate regulatory response. The de Larosière group put forward 18 detailed recommendations including those to develop common rules for investment funds across all 28 EU countries; to cap bankers' bonuses in line with shareholder interests; and to establish a crisis management system for the EU's financial sector. Subsequently the key principles were endorsed by the Commission, prompting the unveiling of a comprehensive financial regulation and supervision reform. This reform includes a supervisory system that combines much stronger oversight at EU level whilst maintaining a clear role for national supervisors. Furthermore, it backs the proposal to set up an early warning body under ECB auspices with the objective of identifying and tackling systemic risks and recommending a core set of regulatory standards throughout the EU. The new European Systemic Risk Board (ESRB, the early warning body) and the European System of Financial Supervisors (ESFS) started operating on 1 January 2011.[39] ESFS, composed of national supervisors and three new European Supervisory Authorities (European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), and European Securities and Markets Authority (ESMA)) have stronger powers than the committees (CEBS, CEIOPS and CESR) that they replace.

Graphic 2: European System of Financial Supervision (ESFS)



38 See above footnote 33.

39 Regulations of the European Parliament and Council establishing the ESRB, the European System of Financial Supervision and the three Authorities are published in the Official Journal of the EU L.311 of 15 December 2010; Further details in DEMARIGNY F. McMAHON J.& ROBERT N. Review of the New European System of Financial Supervision – Part 1, European Parliament, Directorate for Internal Policies, Study, 2013.

48. At EU level, as well as globally, financial stability and strengthening the supervision of the financial sector are regulators' priorities. The role of the three European Supervisory Authorities is central in that respect. They, in particular EBA, had to establish themselves in the middle of an unprecedented crisis of the European banking system. The new regulatory framework provides them with a major opportunity to move towards the establishment of the Single Rulebook reducing fragmentation of rules and practices. Ensuring a level playing field would provide equal conditions of competition for financial service providers in the EU. Referring to the Lamfalussy structure (see paragraph 44), the three Authorities have been given a greater role in Level 2 in drafting delegated acts and implementing measures. At Level 3, they will also develop, harmonize and strengthen supervisory methods.

49. The transformation into legislative measures of many proposals out of the de Larosière Report should underpin a better functioning single market for financial services. Additionally, the ensuing Eurozone crisis highlighted the need for a deeper and better governed economic and monetary union for the single currency to work in the long run. Therefore, the Head of States decided to build up a Banking Union specifically but not only designed for countries which share the Euro. The Banking Union includes a single supervisory mechanism (SSM-entrusted to the ECB)[40] a common system for deposit guarantees (the system in place since 1994 was substantially modified in 2014)[41] a single resolution mechanism (SRM) and a single rule book.[42] The SRM was the most difficult piece of legislation on which Member States had to agree. Directive 2014/59/EU of 15 May 2014 established a framework for the recovery and resolution of credit institutions and investment firms.[43]

D. COMPANY LAW HARMONIZATION

50. Despite the Treaty of Rome's establishment of the European Community in 1958, significant disparities between Member States' company law systems remained until the 1970s. These disparities hampered a deepening of the Internal Market as, for example, corporate board structures and accounting practices differed greatly between the Member States. Therefore, a number of Member States actively insisted that the grant of the right of establishment to companies from all Member States be counterbalanced by at least some degree of harmonization of national company laws. One key objective of company law harmonization was to avoid regulatory arbitrage, whereby companies could choose to incorporate in a Member State with lax company laws and then establish themselves in other Member States. Two further

40 Council Regulation (1024/2013/EU) of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJEU 29 Oct. 2013

41 Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes, OJEU 12 June 2014

42 State of play of the Banking Union on 1.10.2014:
See: *http://ec.europa.eu/finance/general-policy/banking-union/index_en.htm*

43 OJEU 12 June 2014. It was followed by Regulation (EU) No 806/2014 establishing a establishing uniform rules and a uniform procedure for the resolution of credit institutions OJUE 30 July 2014. The SRM, as well as the SSM, require the adoption of a number of other deleted acts and implementing measures, many of which still need to be adopted.

objectives were to facilitate the freedom of establishment of companies and to guarantee legal certainty in intra-Community operations.

51. European company law harmonization was also seen as an integral part of an industrial policy to make European companies more competitive. Directives and regulations had to provide European companies with instruments and rules to facilitate cross-border mergers and cooperation to allow them to trade and restructure at a European level.[44] Policymakers also realized the need for specific action to harmonize financial reporting and financial disclosure practices throughout the EU. These measures were seen as necessary to attain comparability and equivalence of company financial information in order to protect creditors and other third parties. Harmonization was achieved through a series of EU Company Law Directives: the Fourth Company Law Directive on annual accounts of companies with limited liability (1978); the Seventh Company Law Directive on consolidated accounts of companies with limited liability (1983); the Eighth Company Law Directive on the approval of persons responsible for carrying out the statutory audits of accounting documents (1984); the Banking Accounts Directive (1986); and the Insurance Accounts Directive (1991). These directives evolved over time. Most of them were substituted by new legislations that are discussed in greater detail in Section III of this guide.

52. As one of its main objectives, the FSAP (1999) called for an EU-wide review of financial reporting. It reiterated the importance of comparable, transparent, and reliable financial information for efficient and integrated financial markets. In particular, the FSAP highlighted the need to consider how this objective could be aligned with international best practices, which in the Commission's view included International Accounting Standards (IAS). In 2002, a Regulation requiring publicly-traded entities to prepare their consolidated accounts in accordance with IAS (now IFRS) was issued (see paragraph 110).[45]

53. The 2002 Winter Report underlined the need for immediate action on improving the EU framework for corporate governance. This led to the Commission's Communication on Company Law and Corporate Governance in 2003: "Modernizing Company Law and Enhancing Corporate Governance in the European Union: A Plan to Move Forward". The Plan, known as the Company Law Action Plan (CLAP), adopted on 21 May 2003, proposes a set of initiatives aimed at strengthening shareholders' rights, reinforcing protection for employees and creditors, and increasing the efficiency and competitiveness of European business. It also details a series of corporate governance initiatives aimed at boosting confidence in capital markets. The CLAP is based on a comprehensive set of proposals, grouped under six important chapters: corporate governance; capital maintenance and alteration; groups and pyramids; corporate restructuring and mobility; the European Private Company; and cooperatives and other

44 The Third Directive (1978) on mergers and the Sixth Directive (1982) on divisions, as well as the Directive on cross-border mergers (2005) and the Regulations on the Statute for a European Company (2001) and on the European Economic Interest Grouping (1985) fall within this category.

45 Within this paper, publicly-traded companies are those companies with securities admitted to trading on a regulated market in the European Union.

forms of enterprises. It led to the adoption of two Recommendations and a Directive amending the Fourth and Seventh EU Company Law Directives (see Box 1). These Recommendations and Directive are discussed in greater detail in Section III of this guide.

Box 1: Measures adopted in June 2006 (DIR 2006/46/EU) based on measures proposed in the CLAP

Enhanced corporate governance disclosure	Publicly-traded companies required to issue a "corporate governance statement" in their annual report to cover issues such as whether the company complies with a corporate governance code, information about shareholders' meetings and the composition and operation of the board and its committees.
Confirming at EU level the collective responsibility of board members for annual and consolidated accounts	Board members to be collectively responsible for annual and consolidated accounts as well as key non-financial information.
Increasing disclosure of group structure and relations, both financial and non-financial	Companies required to disclose related-party transactions, including "other types of related parties" not previously included in the Fourth Directive.

54. A new comprehensive review took place in 2012. In its Consultation Paper, the European Commission noted that European company law is a cornerstone of the internal market. EU company law has evolved significantly over the last 40 years. The adoption of new company law initiatives has become more difficult although the cross-border dimension of business has grown tremendously both from a company and from a consumer perspective.[46] The Commission's Communication of 12 December 2012 "Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies"[47] outlines the initiatives which the Commission intends to take in order to modernize the company law and corporate governance framework. Improvements include in particular initiatives increasing the level of transparency on corporate governance reporting, shareholder oversight of related party transactions and the information available on groups and recognition of the concept of 'group interest'. The Commission also plans to improve the framework for cross-border operations of EU companies and to adopt a proposal codifying and merging major company law Directives.

[46] EC Consultation on the future of European Company Law: *http://ec.europa.eu/internal_market/consultations/docs/2012/companylaw/questionnaire_en.pdf*

[47] See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52012DC0740:EN:NOT*

3. Accounting and Auditing in the Acquis Communautaire

55. The Treaty of Rome set out conditions to closely coordinate Member States' economic policies and bring about the completion of the Internal Market, based on the principle of an open market economy with free competition. Although the Treaty in its original form did not mention the harmonization of accounting and auditing in the EU, such harmonization grew in importance with the increasing efforts to complete the Internal Market, particularly with regards to company law harmonization. The many differences between national systems of accounting, auditing and company law were perceived to hinder trade and the movement of capital within the EU. Thus, the harmonization of accounting and auditing across the EU became a means by which greater transparency and comparability of financial reporting could facilitate freer trade and movement of capital across Member States (see Box 2: Examples of the Reasons for Harmonization). This section summarizes those parts of the **acquis communautaire** which relate to accounting, financial reporting, and auditing.

Box 2: Examples of the Reasons for Harmonization[48]

1. Creditors	Align safeguards to protect creditors of Limited Liability Companies.
2. Investors, financial analysts, parent-companies, etc.	Need to be able to understand the annual/consolidated accounts of European companies whose shares they might wish to buy, hold, or sell. Also need to appraise the performance of subsidiaries and appraise other European companies for potential takeovers.
3. Preparers	Within multinationals, the effort of accountants to prepare and consolidate accounts is much simplified if annual accounts from all around the EU were prepared on the same basis.

48 Adapted from Christoper Nobes, Robert Parker (2004), *Comparative International Accounting*, Eighth Edition, Harlow, United Kingdom

A. ACCOUNTING: THE ACQUIS COMMUNAUTAIRE AS IT APPLIES TO CORPORATE SECTOR ACCOUNTING

56. Historically, two directives form the base of the **acquis communautaire** on corporate sector financial reporting: the Fourth EU Company Law Directive (1978)[49] ("the Fourth Directive") which covers annual accounts[50] of companies, and the Seventh EU Company Law Directive (1983)[51] on consolidated accounts ("the Seventh Directive"). In adopting these two directives, the EU was attempting to harmonize accounting. However, the directives include dozens of provisions that begin with expressions such as "Member States may permit or require […]." Given this flexibility, the resulting harmonization achieved within the EU was not complete. This might be explained, to some extent, by the differences in the "purposes of various national accounting systems in the EU. They include the differences between creditor orientation in the traditional Franco-German systems and investor orientation in the Anglo-Dutch systems; between law/tax-based rules and private sector standards."[52]

57. Two additional directives were issued to cover the specific nature of the banking and insurance sectors; the Banking Accounts Directive of 1986,[53] and the Insurance Accounts Directive of 1991.[54] Taken together, these four directives are the fundamental pillars of the **acquis communautaire** on corporate sector accounting. They did much to harmonize national legislations with respect to the obligation to prepare annual and consolidated accounts, as well as the audit and publication of accounts.

58. However, EU policy-makers recognized in the mid 1990's that greater harmonization of financial reporting was needed for efficient functioning EU capital markets in an increasingly globalized world. This led to amendments to these directives and the adoption of Regulation (EC) No 1606/2002 of the European Parliament and the Council of July 19, 2002 on the application of International Accounting Standards (now IFRS). Regulation (EC) No 1606/2002 requires companies whose securities are admitted to trading on a regulated market of any Member State (hereafter referred to as 'publicly-traded companies') to present their consolidated accounts in accordance with endorsed IFRS. The key legislation is summarized below (section ii).

59. In line with a program of simplification of existing EU legislations, the Small Business Act (2008) and the Single Market Act (2011), the Fourth and Seventh Directives were substantially revised in 2013. Expected positive effects of the review of the accounting directives include a reduction of administrative burden on micro and

49 For a recent consolidated version of the Fourth EU Company Law Directive, see *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1978L0660:20090716:EN:PDF.*

50 "Annual accounts" was the term used in EU Company Law Directives when referring to legal entity or individual financial statements of a company.

51 For a recent consolidated version of the Seventh EU Company Law Directive, see *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1983L0349:20090716:EN:PDF.*

52 Christoper Nobes, Robert Parker (2004), op. cit., p. 96.

53 For a recent consolidated version of the Banking Accounts Directive, see *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1986L0635:20060905:EN:PDF*

54 For a recent consolidated version of the Insurance Accounts Directive, see *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1991L0674:20060905:EN:PDF*

small enterprises (“think small first”) as well as qualitative improvements for other enterprises in the scope of the directives. An additional objective was to increase the clarity of the text for lawmakers and users in general. The revision process resulted in a new single Accounting Directive covering both single company financial statements and consolidated financial statements. The Directive 2013/43/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings was approved on 26 June 2013.[55] It has to be transposed in the legislation of EU Member States by 20 July 2015. Accordingly, Directives 78/660/EEC and 83/349/EEC were repealed.

60. This third edition of the guide (section i below) will follow the structure of the new Accounting Directive. However, considering that the provisions of the Fourth and Seventh Directives remain relevant until the deadline for transposition, we identify the main differences between the current and the future systems.

i. The foundations of the acquis communautaire on corporate sector accounting

a. The EU default regime for annual and consolidated financial statements

The Accounting Directive applies to limited liability companies

61. The Accounting Directive is the backbone of the **acquis communautaire** on financial reporting for limited liability companies established within the EU. It is based on the Treaty’s provision allowing coordination of legislations with a view to making equivalent throughout the Union the safeguards which are required by Member States of companies, for the protection of the interests of members and others, (Article 50, 2g TFEU). The Accounting Directive is part of the European Company Law whereas in other part of the world, for instance in the USA, financial reporting standards are enforced through securities regulations.[56] In other words, the purpose is here to protect a wider group of users including shareholders, lenders and other creditors, employees, etc. i.e. a larger group than investors on capital markets. This is emphasized by Recitals 3 and 4 preceding the text of the Directive: “Annual financial statements pursue various objectives and do not merely provide information for investors in capital markets but also give an account of past transactions and enhance corporate governance.” As far as undertakings with limited liability are concerned, this is of “special importance for the protection of shareholders, members and third parties”.

62. The Directive covers the annual financial statements and consolidated financial statements of limited liability companies. Article 1.1(a) sets out the types of companies in each Member State, which fall under the scope of the Directive. Article 1 provides a full list of all legal forms of undertakings covered by the Directive detailed by each EU Member State (e.g., in the United Kingdom: public companies limited by shares or by guarantee, private companies limited by shares or by guarantee).

55 OJ EU L.182 of 29.06.2013 – *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32013L0034:EN:NOT*
56 A relatively similar approach is adopted in the EU concerning the application of IFRS (see below – section III,A,ii)

63. Against the background of the Small Business Act, a proposal was made to leave the very small limited companies (micro-entities) out of the scope of the Accounting Directive. The argument was that few of these companies develop their business in more than one Member State. Freedom of establishment is not an issue for them. The principle of subsidiarity should fully apply. The argument was disregarded in the European Parliament, which confirmed the approach adopted in the Fourth Directive in 1978: the requirement to prepare and to publish financial statements is the price to pay for benefiting of a limited liability. If a difference has to be made, it has to result from the level of requirements, which cannot be the same for small or large companies.

64. In application of the principles of subsidiarity and proportionality, partnerships are out-scoped from obligations of the Directive. Usually, the members of a partnership do not benefit from a limited liability regime. Partnerships do not represent the same kind of financial risk for creditors. However, in some cases, a fully liable member of a partnership can be a limited liability company. Article 1.1 (b) of the Accounting Directive includes these partnerships within its scope because, ultimately, members of such partnerships in fact have limited liability for the partnership's obligations. Annex II provides a full list of unlimited legal forms of undertakings covered by the Directive detailed by each EU Member State (e.g., in the United Kingdom: partnerships, limited partnerships, unlimited companies). More broadly, Recital 6 of the Directive states: "The scope of this Directive should be principles-based and should ensure that it is not possible for an undertaking to exclude itself from that scope by creating a group structure containing multiple layers of undertakings established inside or outside the Union."

65. A parent undertaking is required to prepare consolidated financial statements if it has legal or economic control over subsidiary undertakings (wherever they are established). If a parent undertaking is itself a company falling within the scope of Article 1 of the Accounting Directive, it has to prepare both annual financial statements and consolidated financial statements. However, nothing prevents a Member State to require undertakings which do not fall within the scope of Article 1 to prepare consolidated financial statements (Recital 30). Consolidated financial statements integrate the assets and liabilities, profits and losses of the parent company and all of its subsidiary undertakings, after elimination of intra-group transactions and intra-group profits. Subsidiaries are entities which are controlled by the parent company. Article 22 defines the conditions to be a subsidiary. It does not modify substantially the concept of control as described in the Seventh Directive. Control will result from a majority of voting rights, the right to appoint a majority or remove a majority of the members of the administrative, management or supervisory body and the right to exercise a dominant influence over an undertaking pursuant to agreements with fellow shareholders or members. In certain circumstances control may be effectively exercised where the parent holds a minority or none of the shares in the subsidiary. Similarly to the Seventh Directive, the new text also provides for an optional regime of proportional consolidation in the case of joint operations, and also for a number of exemptions including in favor of sub-groups of companies if they are part of a larger group preparing and publishing audited consolidated financial statements in accordance with the Directive, or in an equivalent manner where the parent company is not established in the EU.

66. Not-for-profit undertakings are excluded from the scope of the Accounting Directive.

The Accounting Directive applies a "building blocks" approach from micro to large-sized companies

67. The methodology of the Fourth and Seventh Directives was to provide requirements applicable to the larger companies while granting exemptions to medium-sized and even more exemptions for small companies. The Accounting Directive adopts another approach: essential requirements apply to all undertakings including micro entities. More detailed rules and additional disclosures are imposed to larger undertakings according to their size. This will permit the legislator to clearly define the size of the undertakings to which it wants a new and additional requirement to apply, without multiplying the number of exemptions.

68. The new Directive defines 4 levels of undertakings: micro, small, medium-sized and large (not including public-interest entities to which Regulation (EC) 1606/2002 on the application of IFRS applies as explained later). Additionally, the text defines 3 levels of groups of undertakings. The thresholds used by the Directive to define each level of undertaking are both for annual and consolidated financial statements: balance sheet total, net turnover and average number of employees during the financial year. The undertaking must be within any two of the three thresholds indicated in the table below (box 3) for two successive accounting periods. The values of the monetary thresholds are regularly increased to take into account monetary and economic developments.[57]

Box 3: Thresholds defining categories of undertakings and groups

	Balance sheet total (000 €)	Net turnover (000 €)	Average number of employees
Micro entity	≤ 350	≤ 700	≤ 10
Small undertaking	≤ 4.000	≤ 8.000	≤ 50
Optional increase for Member States	≤ 6.000	≤ 12.000	≤ 50
Medium-sized undertakings	≤ 20.000	≤ 40.000	≤ 250
Large undertaking	> 20.000	> 40.000	> 250
Small group	≤ 4.000	≤ 8.000	≤ 50
Medium-sized group	≤ 20.000	≤ 40.000	≤ 250
Large group	> 20.000	> 40.000	> 250

57 In order to adjust for the effects of inflation, the Commission shall at least every five years review and, where appropriate, amend, by means of delegated acts, these thresholds, taking into account measures of inflation as published in the Official Journal of the European Union." (Article 3.13 of the Accounting Directive)

69. Small groups are exempted from the obligation to draw up consolidated financial statements and a consolidated management report, except where any affiliated undertaking is a public-interest entity. Member States may exempt medium-sized groups from these obligations.

70. There are large differences among Member States regarding how thresholds are set nationally. These reflect differences in policymaking which may be explained by:

- Concerns about the potential inclusion of "public interest" companies: some Member States are concerned that accepting the thresholds set out in the directive may result in including fairly large companies where full financial information is of interest to financial institutions, public and private shareholders and to the public in general.
- Concerns about the impact on SME financial management practices: some Member States are concerned that the relief options may affect the SMEs' financial management practices and, indirectly, the processes of tax collection by Governments.
- The perception by some Member States that higher thresholds for defining SMEs are a key way of limiting the administrative burdens for companies.

71. On 18 December 2008 the European Parliament adopted a non-legislative resolution stating that the accounting directives are often very burdensome for small and medium-sized companies. In line with this resolution, on 14 March 2012, the EU Parliament and Council amended the Fourth Directive to include a hyper-simplified accounting regime to a newly defined category of micro-entities.[58] This amendment was considered in the overhaul of the Fourth Directive, which was simultaneously prepared by the EC. Therefore the Accounting Directive (2013) goes for a maximum harmonization. It prevents Member States from adopting lower thresholds in the definition of small undertakings. Member States are even allowed to increase, at a maximum by one third, the default thresholds for small undertakings' turnover and balance sheet total.

72. By contrast, a public-interest entity, including listed companies, shall be treated as a large undertaking regardless of its net turnover, balance sheet total or average number of employees during the financial year. Consistent with the overarching investor protection policy objective of the EU, the simplifications and exemptions available to small and medium-sized companies do not apply to publicly-traded SMEs (Article 40).

Financial Reporting Principles – Recognition and Measurement

73. The Accounting Directive (2013) states that the objective of the annual accounts is to provide a true and fair view of the financial position and performance of the company, which would normally be obtained by applying the provisions of the directive. However, in exceptional cases the directive requires a departure from the provisions of the directives if that is needed to provide a true and fair view. This so-called

[58] OJ EU L.81 of 21 March 2012; *http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32012L0006*

"true and fair view override" has been extensively discussed and remains a heavily-debated topic in the context of international accounting standard setting.[59]

74. The Directive contains minimum recognition and measurement principles (referred to as "valuation rules" in the directives).[60] Article 6.1 defines general accounting principles, which can be summarized as follows:

» Amounts recognized in the balance sheet and profit and loss account shall be computed on the accrual basis;
» The opening balance sheet for each financial year shall correspond to the closing balance sheet for the preceding financial year;
» Set-off between asset and liability items, or between income and expenditure items, is prohibited;[61]
» Items recognized in the financial statements shall be measured in accordance with the principle of purchase price or production cost;
» The undertaking shall be presumed to be carrying on its business as a going concern;
» Accounting policies and measurement bases shall be applied consistently from one year to the next;
» Recognition and measurement shall be on a prudent basis;
» Components of asset and liability items shall be valued separately;
» Items in the profit and loss account and balance sheet shall be accounted for and presented having regard to the substance of the transaction or arrangement concerned;
» Requirements set out in this Directive regarding recognition, measurement, presentation, disclosure and consolidation need not be complied with when the effect of complying with them is immaterial. However, Member States may limit the scope of this principle to the presentation of financial statements and disclosures.

75. The Conceptual Framework for Financial Reporting of the International Accounting Standards Board (IASB) states "Accrual accounting depicts the effects of transactions and other events and circumstances of a reporting entity's economic resources and claims in the period in which those effects occur, even if the resulting cash receipts and payments occur in a different period" (OB17). This is a fundamental and generally accepted accounting principle; it is usually opposed to "cash accounting", which recognizes the effects of transactions when cash is received or payments occur. The Fourth Directive imposed the respect of accrual accounting principles in all circumstances. By way of simplification, the Accounting Directive 2013 provides however a limited option to Member States, to allow micro entities to apply some form of cash accounting (Article 36 a).

76. Historical cost (purchase price or production cost) remains the default measurement regime in the Accounting Directive 2013. However, by way of derogation,

59 For example, refer to Alexander, D. (1993), A European true and fair view?, European Accounting Review, Vol. 2, No. 1.

60 It should be noted that the Directive includes very few recognition principles. For example, the principles governing the recognition of the revenue from the sale of goods or the rendering of services are only briefly set out.

61 Exceptions to this principle are however possible; See Article 6.2

Article 7 permits Member States to provide for an alternative measurement basis of fixed assets at revalued amounts. This article is narrower than the Fourth Directive which authorized other methods to deal with the consequences of inflation. Furthermore, with the adoption of Regulation (EC) No 1606/2002 and the subsequent endorsement of individual IFRS,[62] new recognition and measurement principles became part of the **acquis communautaire**, in particular measurement at fair value. The Fourth and Seventh Directives were amended in 2001 and 2003 to allow the use of fair value and to pave the way for the endorsement of IFRS. As a consequence, Article 8 of the Accounting Directive 2013 provides for specific rules related to valuation at fair value of financial instruments, including derivatives. Member States may even permit or require fair value measurement of specified categories of assets other than financial instruments. The Directive defines how fair value will be determined, whether changes in fair value will be included in the income statement or directly in equity, and what information needs to be disclosed in the notes.

77. Moreover, some recognition and measurement options allow Member States to closely align financial reporting requirements with tax accounting.[63] This may be explained by the fact that "in most continental European countries […], the traditional paucity of 'outside' shareholders has meant that external financial reporting has largely been invented for the purposes of protecting creditors and for governments, as tax collectors or controllers of the economy. […] It also seems likely that the greater importance of creditors in these countries leads to more careful (prudent, conservative) accounting."[64] This approach raises questions concerning some principles mentioned above mainly those of prudence, and substance over form. Prudence is highly debated because some preparers (ab)use it to validate undervaluation of assets or overvaluation of liabilities for taxation purpose. The Directive also authorizes applications of this principle, for instance related to provisions[65] that would not be fully in line with IFRS. Despite the risk of misinterpretation, prudence should however continue to play an important role.[66] "Substance over form" raises similar problems, which generated to long discussions in the preparation of the Directive. Therefore Article 6.3 allows Member States to provide for exceptions to this principle.

78. An undertaking which draws up consolidated financial statements applies the same measurement bases as are applied in its annual financial statements. However, Member States may permit or require that other measurement bases be used. We

62 To be adopted for application in the EU a standard must meet the conditions set out in Article 3 of Regulation (EC) No 1606/2002: Its application must result in a true and fair view of the financial position and performance of an enterprise; it must be conducive to the European public good; and it must meet basic criteria as to the quality of information required for financial statements to be useful to users.

63 Gielen F. and Hegarty J.(2007) "An Accounting and Taxation Conundrum: The Relationship between Corporate Income Tax, Accounting and Financial Reporting: A Pan-European Perspective in the Context of Adoption of International Financial Reporting Standards (IFRS)" World Bank, Washington

64 Nobes C. and Parker R. (2004), op. cit., p. 23.

65 Article 6 states: "Only profits made at the balance sheet date may be recognized" and 6.5: "Member States may permit or require the recognition of all foreseeable liabilities and potential losses arising in the course of the financial year concerned or in the course of a previous financial year, even if such liabilities or losses become apparent only between the balance sheet date and the date on which the balance sheet is drawn up."

66 See for instance EFRAG Bulletin (2013), "Getting a Better Framework: Prudence", EFRAG, Brussels.

highlight Article 24 of the Directive: “Where assets included in consolidated financial statements have been the subject of value adjustments solely for tax purposes, they shall be incorporated in the consolidated financial statements only after those adjustments have been eliminated.” This means that, in principle, it will be easier to comply with the objective of true and fair view in consolidated financial statements than in the annual accounts.

Presentation of Annual Financial Statements and Disclosures

79. Both annual financial statements and consolidated financial statements must include a balance sheet, a profit and loss account, and notes on the accounts. The Directive does not require a cash flow statement or a statement of changes in equity. However, Article 4.1 states: “Member States may permit or require undertakings other than small undertakings to include other statements in the annual financial statements in addition to the documents referred to in the first subparagraph.”

80. The Accounting Directive 2013 sets out standardized formats for the lay-out of the balance sheet and the profit and loss accounts (the number of possible layouts has been reduced compared to the Fourth Directive). It describes the nomenclature and the terminology of items in the balance sheet and profit and loss account. It also defines the minimum contents of the notes to the annual accounts. However, the Directive does not impose a uniform chart of accounts as exists, for example, in Belgium, France or Spain.

81. The “building block approach” applies mainly in the presentation of financial statements. The lay-out and also the number of notes to the accounts vary according to the size of the undertaking.

» Micro-entities have to provide minimum information in the balance-sheet and the profit and loss account as explained in Article 36; additionally the number of notes to the accounts is strictly limited (Article 16.3).
» Small companies can be allowed to draw up abridged balance sheet and profit and loss accounts (Article 14.1); as for micro-entities, the number of notes to the accounts is strictly limited (Article 16.3).
» Medium-sized companies can be allowed to prepare aggregate profit and loss information (Article 14.2), to disclose a larger but still reduced number of information in the notes (Article 17) and not to draw up consolidated accounts (Article23).
» Large companies and public interest entities are not entitled to benefit from exemptions. They are submitted to the largest number of disclosures (Article 18).

82. The Accounting Directive 2013 requires the same standardized formats for the layout of the consolidated balance sheet and the consolidated profit and loss statement as for annual financial statements. It further sets out a number of essential adjustments resulting from the particular characteristics of consolidated accounts as compared with annual accounts (e.g., minority interests).

83. The Directive defines the minimum contents of the notes to the annual financial statements. Some notes explain the basis for recognition and measurement of items. Others provide a disaggregation of amounts in the balance sheet or the profit and loss account. Undertakings are also required to disclose off-balance-sheet arrangements and related-party transactions in the notes. The list of disclosures is similar for consolidated financial statements but the undertaking must add specific information about the subsidiary undertakings included in the consolidation, such as their registered office and the proportion of the capital held by the parent undertaking.

Non-Financial Information

84. The **management report and the consolidated management report** are not components of financial statements. They are however important elements of financial reporting because their main purpose is to provide the reader with a balanced and comprehensive analysis of the development and performance of the undertaking's business and of its position, together with a description of the principal risks and uncertainties that it faces. Article 19 of the Accounting Directive requires that the analysis includes both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters. This Article provides a list of non-financial information to be included in the management report that is supplemented by Article 29 concerning the consolidated management report. Where a consolidated management report is required in addition to the management report, the two reports may be presented as a single report (Article 29.3).

85. Member States may exempt micro and small undertakings from the obligation to prepare management reports. Medium-sized undertakings must prepare a management report but Member States may exempt them from the obligation to disclose non-financial information relating to environmental and employee matters (Article 19.3 and .4).

86. Non-financial information remains an area for future development. The European Commission proposed on 16 April 2013 a directive enhancing the transparency of certain large companies on social and environmental matters. The Directive was approved on 22 October 2014 and published in the Official Journal on 15 November 2014. Large public-interest entities (mainly listed companies and financial institutions) with more than 500 employees will be required to disclose relevant and useful environmental and social information in their management reports. Disclosures relate to policies, risks and results as regards environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on the boards of directors, well beyond what is currently required by Article 29 of the Accounting Directive 2013.

87. Public interest entities are required to include a **corporate governance statement** in their management report. This statement refers to the corporate governance code to which the undertaking is subject. It provides information on the composition and operation of the administrative, management and supervisory bodies and their

committees. It also provides a description of the main features of the undertaking's internal control and risk management systems in relation to the financial reporting process.

88. A new kind of disclosure has been introduced in Chapter 10 of the Accounting Directive in 2013: "Member States shall require large undertakings and all public-interest entities active in the extractive industry or the logging of primary forests to prepare and make public a report on payments made to governments on an annual basis." This **country by country reporting** should enhance transparency of payments made to governments of resource-rich countries.

Publication, Responsibility and Statutory Audit

89. The Accounting Directive 2013 (Article 30) requires undertakings falling within its scope to publish their financial statements, consolidated financial statements, management report, consolidated management report, and the statutory auditor's report by filing them with a commercial register (e.g., the Companies House in the United Kingdom). The publication of the accounting documents follows the mechanisms set out in the First EU Company Law Directive (the "First Directive" 2009/101/EC). This Directive requires Member States to provide for appropriate penalties in the case of failure to disclose these accounting documents. Recital 39 of the Accounting Directive strongly encourages Member States to develop electronic publication systems, already existing in a number of countries, which allow undertakings to file accounting data, including statutory financial statements, only once and in a form that allows multiple users to access and use the data easily. Member States may, however, exempt undertakings from the obligation to publish the management report where a copy of all or part of any such report can be easily obtained upon request at a price not exceeding its administrative cost.

90. Small undertakings may be exempted from the obligation to publish the full set of information included or accompanying financial statements. Not only may Member States exempt them from preparing and publishing management reports but they may also exempt them from the requirement to publish the profit and loss account. (Article 31.1) Micro undertakings can even be totally exempted from publication of their financial statements provided that the balance sheet information contained therein is duly filed with at least one competent authority designated by the Member State concerned. (Article 36.1.d)

91. The members of the administrative, management and supervisory bodies of the company must be collectively responsible at least to the company for the annual financial statements, the consolidated financial statements, the management report, the consolidated management report and, when required, the corporate governance statement. Article 33 of the Accounting Directive, initially introduced into legislation in 2008, translates a recommendation made in the Winter Report.

92. The scope of statutory audit also derives from the Accounting Directive which requires that, except for the exemptions available for small companies, annual ac-

counts of all limited liability companies be audited by an approved statutory auditor. The statutory auditors are also required to express an opinion concerning the consistency of the annual report with the annual accounts. A comprehensive regime applicable to statutory auditors is defined by the Directive 2006/43/EC that if further commented in section III.B of this guide.

b. Directive on the Annual Accounts of Banks and other Financial Institutions (The "Bank Accounts Directive")

93. The Fourth and Seventh Directives acknowledged the special nature of the activities of banks and other financial institutions (hereafter referred to as "banks") and of insurance undertakings by allowing Member States not to bring those bodies within the scope of the directives when implementing them. The gap in respect of banks and other financial institutions was filled by the Bank Accounts Directive, and the gap in respect of insurance undertakings was filled by the Insurance Accounts Directive.

94. The Bank Accounts Directive (86/635/EEC)[67] applies to annual and consolidated accounts of banks established in the EU regardless of their legal form (but not to branches, see paragraph 106). The Bank Accounts Directive covers the same areas as the accounting directives and most general provisions are to be read across directly from them. Apart from applying these read-across provisions to banks, the Directive sets out specific balance sheet and profit and loss statement layouts; it determines what items should be included under each statement heading; it requires a number of additional disclosures in the notes to the accounts; it establishes specific measurement principles; and it adapts the consolidation requirements set out in the Seventh Directive.

95. The provisions set out in the Directive contain a number of Member State options:

- **Hidden reserves** – Member States have the option to allow banks to understate by up to 4 per cent the value of certain assets (e.g., loans and advances). The principal arguments for the maintenance of these "hidden reserves" – which had been widely used in the past – related to the importance of maintaining confidence and thus stability in financial markets and the consequent need to smooth out the fluctuation in profits from year to year inherent in the banking business. The principal arguments against the maintenance of the "hidden reserves" were that they limit the usefulness of the profit figure in the accounts as an indicator of performance and that their existence is inconsistent with the need for creditors and shareholders to be in a position to make informed assessments of a bank's financial strength, its short-term performance and long-term trends.
- **Fund for general banking risks** – If the "hidden reserves" option is not exercised, Member States have the option to permit banks to create a fund for general

67 For the most recent consolidated version of the Bank Accounts Directive, see *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1986L0635:20060905:EN:PDF*

banking risks; if “hidden reserves” are not permitted, the Directive requires that banks be permitted to create such a fund. The fund is intended as a means of allowing banks to set aside amounts required to cover ‘the particular risks associated with banking’ and is disclosed as a balance sheet liability.

» **Foreign currency translation** – The general rule was that assets and liabilities should be translated at the spot rate at the balance sheet date. Member States may, however, require or permit assets held as non-monetary assets to be translated at the rates ruling on the dates of their acquisition. Outstanding forward and spot exchange transactions should be translated at the spot rates of exchange ruling on the balance sheet date. However, Member States may require forward transactions to be translated at the forward rate ruling on the balance sheet date. The Directive also included a number of other options regarding foreign exchange translation.

96. There is some doubt as to whether the application of the specific recognition and measurement possibilities of the Bank Accounts Directive provides a true and fair view of the financial position and performance of banks. Also, the many options available to Member States hinder comparability within the EU. At the time of the adoption of the Directive, the most important policy prerogative appeared to be maintaining public trust in the stability of the banking sector through allowing income smoothing and the creation of reserves. The requirement to apply endorsed IFRS changed this drastically for publicly-traded banks, which prepare consolidated accounts (see paragraph 110).

97. Since IFRS became mandatory for the consolidated accounts of publicly-traded banks, the Committee of European Banking Supervisors (which is now transformed into the **European Banking Authority** – EBA) has issued guidance on a standardized financial reporting framework for banks based on IFRS (FINREP).[68] This framework should enable banks to use the same standardized data formats and data definitions for financial reporting in all countries where the framework is applied. This is intended to reduce the reporting burden for banks that have cross-border operations, and lower barriers to the development of an efficient internal market in financial services. These Guidelines have been frequently revised to increase harmonization as well as to reflect changes in the accounting standards and Capital Requirements Directive. Changes in IFRS endorsed by the European Commission have been incorporated into the revised FINREP. Based on the new Capital Requirement Directive CRD.IV, the EBA should develop an implementing technical standard replacing FINREP Guidelines.

98. EBA has also published Guidelines on Common Reporting (COREP).[69] These guidelines are intended to be used by banks when preparing prudential reports to be sent to any EU Supervisory Authority according to the new capital framework

68 See *http://www.eba.europa.eu/regulation-and-policy/Supervisory-Reporting*

69 See *http://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/guidelines-on-common-reporting-2011-*

established in the new Capital Requirements Directive (CRD.IV), which implements the revised international capital framework (Basel III) in the EU. Following the adoption of the CRD.IV, EBA should develop a set of implementing technical standards on supervisory reporting replacing existing Guidelines.[70]

c. Insurance Undertakings Directive (the "Insurance Accounts Directive")

99. The Insurance Accounts Directive (91/674/EEC)[71] draws on a large number of the provisions in the Fourth and Seventh Directives which had not, until then, applied to insurance undertakings. Notwithstanding a few exceptions (e.g., undertakings which are not companies within the meaning of Article 54 TFEU and certain bodies or mutual associations), the Directive applies to undertakings engaged in life, non-life or reinsurance business.

100. Financial statements of insurance undertakings comprise a balance sheet, a profit and loss account, and notes. The Directive requires that the accounts be prepared in accordance with its detailed provisions and by reference to the accounting directives[72] requires that individual and consolidated accounts give a true and fair view of the financial position and performance of insurance undertakings. While the Directive broadly harmonizes accounting for insurance undertakings in the EU, the existence of numerous options restricts comparability. The requirement to apply endorsed IFRS changed this drastically for publicly-traded insurance undertakings which prepare consolidated accounts (see paragraph 110).

101. The differences from the requirements which are imposed on companies in general (through the accounting directives) include, but are not limited to, the following issues:

- **Valuation of investments** – Most of the assets of insurance undertakings are investments held to meet future liabilities to policyholders and therefore there is considerable interest in the method of valuation employed. The categories of fixed and current assets required by the accounting directives are abandoned in favor of a single concept of investments which includes all lands and buildings.[73] The Directive states that investments may be valued either according to historical cost principles or at current value (values according to the non-chosen option should however be presented in the notes). It does not seek to choose between the merits of either method.

70 A final draft "Implementing Technical Standard on Supervisory Reporting (COREP, COREP Large Exposures and FINREP) has been adopted by the EBA and submitted to the European Commission in July 2013 and is available on the EBA's website: *http://www.eba.europa.eu/documents/10180/359626/EBA+ITS+2013+02+%28Draft+ITS+on+supervisory+reporting%29.pdf/f3e58351-8aec-4827-8e8e-628525122414*

71 For the most recent consolidated version of the Insurance Accounts Directive, see *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31991L0674:EN:NOT*

72 References to the Fourth and Seventh Directives must be construed as references to the Accounting Directive (2013). A correlation table is provided for in Annex VII (Article 52).

73 Land and buildings occupied by the insurance undertaking must be disclosed separately.

- **The fund for future appropriations** – A Member State may permit an insurance undertaking to include amounts whose allocation either to policyholders or to shareholders remains undetermined at the close of the financial year. It is largely a holding account to enable a smooth flow of surplus to emerge.
- **Deferred acquisition costs** – The Directive requires that the costs of acquiring insurance policies be deferred in accordance with the accounting directives insofar as a Member State decides not to prohibit deferral.
- **Technical provisions** – The Directive requires insurance undertakings to draw sector specific provisions, including technical provision for unearned premiums, life assurance provision, claims outstanding and equalization provisions.[74]

102. The European Insurance and Occupational Pensions Authority (EIOPA) was established as a part of a European System of Financial Supervisors to supervise the financial sector in the European Union. It is carrying out a significant amount of work to improve the links between annual/consolidated accounts and supervisory reporting by insurance undertakings. This issue is particularly important in the context of the Directive 2009/138/EC of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) as it relates to supervisors' needs for accounting information.[75]

103. The prudential directives[76] and more specifically in future the Solvency II Directive require every insurance undertaking to submit to the supervisory authorities the information which is necessary for the purposes of supervision. Article 35 of the Solvency II Directive empowers the European Commission and EIOPA, each in their field of competence to specify the required information, with a view to ensuring to the appropriate extent convergence of supervisory reporting.

104. However, Member States have to a large extent cross-used financial reporting and supervisory reporting requirements to arrive at a situation where the same accounting rules are used for both purposes. Several Member States use the same set of accounts in principle without adjustments; others perform certain adjustments or require additional information for supervisory purposes. A few Member States have more extensive supervisory reporting rules, in certain cases leading more or less to a separate set of prudential financial statements. However even these separate financial statements normally take their starting point in the annual and consolidated accounts.

105. The European Commission evaluated different accounting alternatives for the Solvency II project. In that context, there appears to be increasing alignment between

74 Provision to compensate the frequent fluctuation in claims that characterizes natural events

75 The Solvency II Directive (OJ-EU, L 335 of 17.12.2009) is a fundamental and wide-ranging review of the current insurance Directives to ensure adequate policy-holder protection in all EU Member States. The transposition date has been postponed to 1 January 2016 (Directive 2013/58/EU – OJ-EU, L 341 of 18.12.2013) because the Solvency II Directive needs to be amended in order to take into account the new supervisory architecture for insurance, namely the setting-up of the EIOPA. *http://ec.europa.eu/finance/insurance/solvency/solvency2/index_en.htm*

76 See Directive 73/239/EEC Article 19, Directive 79/269/EEC Article 23.

the unfolding proposals for Solvency II and the IASB project on Insurance Contracts (Phase II). The IASB issued a revised exposure draft for a standard on insurance contracts in June 2013 which could be finalized in 2014. The Committee of European Insurance and Occupational Pensions Supervisors (which is now transformed into the **European Insurance and Occupational Pensions Authority** – EIOPA) advised the European Commission on the development of Solvency II considering that disclosures made by insurance undertakings under financial reporting, listing or other legal or regulatory requirements may be relied upon to fulfill the equivalent supervisory disclosure requirements.[77]

d. Other relevant Company Law Directives and "soft law" Instruments

106. A number of other important directives and "soft law" instruments relate to accounting, including:

- Directive 2009/101/EC on coordination of safeguards for the protection of the interests of members and third parties:[78] Among other things, this Directive requires companies to publish specific company information in a commercial register or companies register in the Member State in which they are registered. Member States shall ensure that the filing of all documents is possible by electronic means. Financial information which is required to be published in accordance with EU directives must be part of documents available in the register. A copy of the whole or any part of the documents must be obtainable on application by paper means or by electronic means as the applicant chooses.
- Directive 2012/30/EU on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent.[79] This Directive sets forth the means of coordination of safeguards for the "minimal equivalent protection for both shareholders and creditors" of public liability companies. It provides therein two principles which Member States must adhere to, i.e. (i) the minimal capital with which a company must initially begin and subsequently maintain, and (ii) the shareholders' rights regarding the issuance of new capital and the payment for shares. It includes detailed rules on the formation and the maintenance, increase or reduction of their capital. Profit distribution is also regulated.
- Directive 2011/35/EU concerning mergers of public limited liability companies and Directive 82/891/EEC concerning the division of public limited liability companies know as Third and Sixth Directives.[80]

77 CEIOPS "Advice to the European Commission on Supervisory Reporting and Public Disclosure in the Framework of the Solvency II project" CEIOPS-DOC-03/07, March 2007

78 See *http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32009L0101.* Before 21 October 2009, this Directive was referred to as the First Company Law Directive – 68/151/EEC

79 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32012L0030:EN:NOT* Before 25 October 2012, this Directive was referred to as the Second Company Law Directive (77/91/EEC)

80 Third Directive: *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32011L0035:EN:NOT* and Sixth Directive: *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32011L0035:EN:NOT*

» Directive (89/666/EEC) on Disclosure Requirements in Respect of Branches:[81] The Eleventh Directive, adopted in 1989, sets forth the disclosure requirements for branches of companies operating in Member States. These branches can be of a company under the jurisdiction of another Member State or of a third country. While subsidiaries of companies incorporated in one Member State fall under the jurisdiction of the host Member State, the treatment of foreign branches of a company was unclear until the adoption of the Eleventh Directive. Directive 89/117/EEC on Accounting Documents of Branches of Foreign Credit and Financial Institutions[82] extends the scope of the Eleventh Council Directive to include branches of credit institutions.
» Recommendation 2001/453/EC on Recognition, Measurement and Disclosure of Environmental Issues in the Annual Accounts and Annual Reports of EU Companies:[83] This Recommendation was adopted in order to address the lack of harmonization of Member States ’ rules and definitions as to the disclosure of environmental information. Because this information was considered unreliable or often lacking altogether, this Commission Recommendation seeks to set a standard for disclosure. It will be largely superseded by the new Directive on Non-Financial Information (see paragraph 84).

B. FINANCIAL REPORTING FOR ISSUERS ON EU REGULATED FINANCIAL MARKETS

i. Developing Integrated and Liquid Capital and Financial Services Markets

107. The above mentioned accounting directives brought about a degree of harmonization and improvements in the quality of financial information across the EU. However, by the end of the 1990s it was clear that financial statements drawn up in compliance with the Fourth and Seventh Directives did not fully help to achieve the policy objectives of the EU, including the creation of an integrated market in financial services as set out in the FSAP adopted in May 1999.

108. In a Communication of 1995,[84] the European Commission acknowledged that the Fourth and Seventh Directives do not provide answers to all the problems facing the preparers and users of accounts and accounting standard setters. The result of this last problem is that large European companies seeking capital on the international capital markets, most often on the New York Stock Exchange, are obliged to prepare a second set of accounts for that purpose. This is burdensome and costly and constitutes a clear competitive disadvantage. Four possibilities were considered:

81 See *http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!DocNumber&lg=en&type_doc=Directive&an_doc=1989&nu_doc=666*
82 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31989L0117:EN:HTML*
83 See *http://eur-lex.europa.eu/LexUriServ/site/en/oj/2001/l_156/l_15620010613en00330042.pdf*; More recently, the EC proposed a directive on disclosure of non-financial and diversity information by certain large companies and groups – see above paragraph 85
84 EC Communication “Accounting Harmonisation: A new strategy vis-à-vis international harmonisation” doc COM (1995), 14 November 1995.

(1) To exclude listed companies from the scope of application of the Directives and free them to follow other rules; (2) To update the Accounting Directives, to include technical solutions for the various accounting issues which have not yet been dealt with; (3) To develop a comprehensive set of European accounting standards; (4) To adopt under conditions international accounting standards which have a clear prospect of recognition in the international capital markets. The last solution was considered to be the most feasible. In 2000, the EC outlined a strategy designed to help eliminate remaining barriers to cross-border trading in securities, in particular by recommending that there be one set of accounting standards so that company accounts throughout the EU are more transparent and can be more easily compared. The EC indicated that the adoption of IFRS (then International Accounting Standards) was the way forward.[85]

109. Right at the outset, the European Commission stressed two fundamental preconditions for achieving its policy objectives, i.e.:

» The need for legal certainty: To achieve this, the EC contemplated the establishment of an endorsement mechanism with a two-tier structure consisting of a technical level and a political level at EU level to confirm the standards that will have to be applied (See Box 4: Major Bodies involved in the Endorsement of IFRS in the EU).
» The need for proper enforcement: The Communication noted that high quality accounting standards will not automatically guarantee transparent financial reporting per se; rigorous and disciplined application is vital to the credibility of accounts. To achieve this, the EC stressed the need for high-quality statutory audit (which partly led to the revision of the Eighth EU Company Law Directive as discussed in paragraph 129) as well as strengthened co-ordination among European securities regulators in order to establish equivalent, high-level enforcement of financial reporting throughout the EU.

ii. Regulation (EC) 1606/2002 on the Application of IFRS

110. Regulation (EC) 1606/2002 of the European Parliament and of the Council on the application of IFRS[86] ("Regulation 1606/2002") was issued on July 19, 2002. It requires publicly-traded companies, including banks and insurance companies, to prepare their consolidated accounts in accordance with IFRS endorsed by the EU for financial years beginning January 1, 2005.[87] Within this paper, "publicly-traded companies" are those companies with securities admitted to trading on a regulated market in the EU (See Box 4: Regulated Market). Understanding what a "regulated market" entails is therefore important to assess the actual scope of Regulation 1606/2002.

85 EC Communication "The EU's Financial Reporting Strategy: The Way Forward" doc. COM (2000)359 of 13 June 2000

86 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2002R1606:20080410:EN:PDF.*

87 The Regulation allows Member States to defer the application of certain provisions until 2007 for those companies publicly-traded both in the EU and on a regulated third-country market which are already applying another set of internationally accepted standards as the primary basis for their consolidated accounts as well as for companies which have only publicly-traded debt securities.

Application of IFRS in Annual Accounts

111. In accordance with the principle of subsidiarity, Regulation 1606/2002 gives Member States the option to permit or require publicly traded companies to prepare their financial statements in conformity with endorsed IFRS. As of the date of this publication, a minority of Member States have exercised the option to require the use of IFRS in their financial statements by listed companies (e.g. Bulgaria, Cyprus, Czech Republic, Estonia, Greece, Latvia, Lithuania, Malta and Slovakia). Additionally, eight Member States used the option to permit IFRS in the annual accounts for listed companies. The Commission updates regularly a table summarizing the intentions/decisions of Member States and EEA countries concerning the use of options in Regulation 1606/2002.[88]

Box 4: Regulated Market

A "regulated market" is defined in Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID). However, the European Parliament and Council agreed on a text substantially revising this directive. The text was formally approved in Parliament on 15 April 2014 and came into force on 2 July 2014. Although it no longer provides a "definition", Article 47 of the new Directive states that "Member States shall reserve authorization as a regulated market to those systems which comply with the provisions of this Title." This allows a clear identification of the scope of the concept of regulated market.

In accordance with Article 58 of the recast MiFID Directive (Article 47 of the current text), each Member State draws up a list of the regulated markets for which it is the home Member State and forwards it to the Securities regulator.[89] ESMA publish and keep up-to-date a list of all regulated markets on its website.

In the UK, for example, the Main List is a "regulated market". By contrast, the Alternative Investment Market ("AIM") is an "exchange-regulated market" (under MiFID, exchange-regulated markets are now referred to as "multilateral trading facilities" (MTFs). Therefore, companies quoted on AIM are not subject to the requirements of Regulation 1606/2002.

112. Also, Member States may extend this permission or this requirement to other companies as regards the preparation of their consolidated accounts and/or their annual accounts. All Member States have to some extent exercised the option to allow other companies to use IFRS for their consolidated financial statements. By contrast, few Member States allow (or, to a lesser extent, require) not publicly traded com-

88 The last published survey closed on 1 July 2010: *http://ec.europa.eu/internal_market/accounting/docs/ias/ias-use-of-options_en.pdf.*

89 See *http://ec.europa.eu/internal_market/securities/isd/index_en.htm.*

panies to use IFRS in their annual accounts. This is largely explained by the fact that IFRS are (increasingly) developed to address the needs of large, publicly accountable entities as implicitly recognized by the IASB's Basis for Conclusions of the IFRS for Small and Medium-sized Entities (IFRS for SMEs). The IASB noted that "circumstances of SMEs can be different from those of larger, publicly accountable entities in several ways, including:

a. The users of the entity's financial statements and their information needs;
b. How the financial statements are used;
c. The depth and breadth of accounting expertise available to the entity; and
d. SMEs' ability to bear the costs of following the same standards as the larger, publicly accountable entities".

Legal Certainty

113. The IASB is the body which issues International Financial Reporting Standards (IFRS).[90] However, IFRS are not automatically adopted by the EU as they are issued by the IASB. Instead, each standard must first be endorsed individually by the European Commission before it can enter into force. Article 3 of Regulation 1606/2002 sets three conditions that individual IFRS must meet in order to be endorsed and adopted for use under this Regulation:

» Its application must result in a true and fair view of the financial position and performance of an enterprise: this principle is considered in the light of the accounting directives but does not imply a strict conformity with each and every provision of those directives;
» It must be conducive to the European public good (this is sometimes interpreted as follows: "IFRS accounts should build the foundation of a level playing field for European companies to compete for financial resources on EU and international capital markets); and
» It must meet basic criteria as to the quality of information required for accounts to be useful to users (i.e., the understandability, relevance, reliability and comparability required of financial information needed for making economic decisions and assessing the stewardship of management).

114. As of the date of this publication, the European Commission has endorsed or is about to endorse all existing standards or amendments to standards (IAS and IFRS) issued by the international standard setter and which are still applicable. However, concerning financial instruments, some differences continue to exist. IAS 39 was approved with a "carve out" of some paragraphs concerning fair value hedge accounting. IASB intends to replace IAS 39 in different phases. These standards and proposed standards are very much debated in Europe and none of them has been endorsed so far. The endorsement process requires time. Consequently, there will always be a risk that some standards become applicable in Europe at a later date than the one defined by the IASB.[91] Regulation 1606/2002 also requires that interpretations of the

90 See *http://www.iasb.org/Home.htm.*

91 EFRAG frequently updates the Endorsement Status Report. The report contains an overview per issued standard and interpretation, listing the date of the endorsement date and the date the endorsed standard/interpretation was published in the Official Journal of the European Union. See *http://www.efrag.org/content/default.asp?id=4090*

standards be endorsed following the same procedure. All interpretations by SIC before 2001 and the IFRS Interpretation Committee after this date were also approved so far by the European Commission.

115. The endorsement process established by the Commission in accordance with Regulation 1606/2002 involves a number of stakeholders (as illustrated in Box 5: Major Bodies involved in the endorsement of IFRS in the EU). The endorsement mechanism was established to act expeditiously on Standards and Interpretations adopted by the IASB. It also provides a framework to deliberate, reflect and exchange information on IFRS among the main stakeholders, in particular national accounting standard setters, supervisors in the fields of securities, banking and insurance, central banks including the European Central Bank, the accounting profession and users and preparers of accounts.

Box 5: Major Bodies involved in the Endorsement of IFRS in the EU

1. **The European Financial Reporting Advisory Group (EFRAG),**[92] is a private sector initiative set up in 2001 by a number of parties in Europe involved in financial reporting (e.g., users, preparers, the accountancy profession, national standard setters). Its work can be categorized into two main tasks: providing input to the IASB in the standard-setting process, and providing technical advice to the European Commission on the application of IFRS in Member States. When the IASB issues a new standard, EFRAG reviews it and issues an opinion on it; EFRAG also elaborates an analysis on costs and benefits of each single IFRS for both EU users and preparers and forwards the documents to the EC. EFRAG is made up of a Technical Expert Group (TEG), which conducts the majority of the technical evaluation and advice, and a Supervisory Board to ensure European interest and legitimacy. EFRAG is to act in the interest of Europe as a whole, not in any national or other interest to avoid sectarian biases. EFRAG's technical group meets on a monthly basis and advises the Supervisory Board that responds to the Commission with endorsement advice within two months of an IFRS being published by the IASB.[93] The EU contributes to the funding of EFRAG,[94] the role of which has been confirmed in the Report of Philippe Maystadt, Special Advisor to the EC issued in November 2013.[95]

2. **The Accounting Regulatory Committee (ARC)**[96] was established by Article 6 of Regulation 1606/2002 to provide the EC with an opinion on proposals to endorse new IFRS and amendments thereto. It is composed of high-level

92 See *http://www.efrag.org/*
93 The Standard Advice Review Group established in 2006 to supervise the endorsement process, although not formally abolished, is no longer active; See *http://ec.europa.eu/internal_market/accounting/governance/committees/sarg/index_en.htm*
94 Regulation (EU) No 258/2014 of 3 April 2014 establishing a Union programme to support specific activities in the field of financial reporting and auditing for the period of 2014-20, OJ EU, L 105 of 8 April 2014
95 See *http://ec.europa.eu/internal_market/accounting/docs/governance/reform/131112_report_en.pdf*
96 See *http://ec.europa.eu/finance/accounting/governance/committees/arc/index_en.htm*

Member State representatives, mainly from the respective Ministries of Finance, and is chaired by the EC. The ARC decides on the applicability of the IFRS within the EU based on existing Member State and Community legislation.

3. The **European Commission** first receives the technical opinion from EFRAG. The EC then makes a proposal to either adopt or reject the standard (or amendment) and submits this proposal directly to the ARC along with a report detailing the standard and its conformity with the existing accounting directives. The Commission can endorse the standard if:
   - the ARC approves the standard and the European Parliament and the Council do not oppose; or
   - in the event the ARC does not approve the standard, the Commission may override the ARC's refusal with support from the Council and the European Parliament.

4. When the ARC issues a positive opinion on a standard, the Commission then forwards it on to the Parliament and to the Council , which have a three-month period to scrutinize the standard. Should the Parliament[97] or the Council[98] oppose the proposed standard, the Commission may not adopt it.

116. Regulation 1606/2002 required the European Commission to assess the operation of this Regulation and to report thereon to the European Parliament and to the Council by 1 July 2007 at the latest. A report was issued on 24 April 2008, concluding that "the value of the accounting information supplied has increased and IFRS have generally been applied consistently in the EU. The level of consistency between IFRS accounts is likely to increase over time as preparers and auditors gain experience with applying the new accounting framework." However, the governance of the IASB and the influence of Europe, which was the main region in the World having introduced a mandatory requirement to apply IFRS, raised questions and generated debates in the European Parliament. After important constitutional reforms of the IASB in 2009, 2010 and 2013, the EC decided to assess the EU endorsement mechanism and in particular the effectiveness of the arrangements in securing cooperation between EFRAG and national standard setters in Europe. A report was tabled by Mr. Philippe Maystadt, former President of the European Investment Bank, as Special Advisor to the EC in November 2013.[99] The Report confirms: "The initial objective that motivated the adoption of IFRS by the European Union does not seem to be challenged in Europe. Moreover, the G20 maintains its support for a single set of global quality rules. The IFRS are the best choice at the moment." However it recommends the improvement of the IFRS adoption criteria and substantial changes in the governance of EFRAG to better involve national standard setters in the decision process.

97 See *http://www.eurparl.europa.eu/news/public/default_en.htm*

98 *http://www.consilium.europa.eu/showPage.aspx?id=1&lang=en*

99 See *http://ec.europa.eu/finance/accounting/governance/reform/index_en.htm*

Proper Enforcement

117. The European Commission had recognized that only properly enforced IFRS would bring about the expected policy objectives (see paragraph 109). Proper enforcement was one of the pre-conditions for the U.S. Securities and Exchange Commission (SEC) to eliminate the need for reconciliation between IFRS and U.S. GAAP for European companies issuing securities on U.S. capital markets.

118. In this context, Regulation 1606/2002 requires Member States to take appropriate measures to ensure compliance with IFRS. The Committee of European Securities Regulators (CESR) has developed a common European approach to enforcement. It published two statements on enforcement activities: Standard n°1 on Enforcement of standards on financial information and Standard n°2 on Co-ordination of Enforcement Activities.[100] This task is taken over today by the **European Securities and Market Authority (ESMA)**.[101] Within CESR and now ESMA, the European Enforcers Coordination Sessions (EECS) act as a peer pressure group. National accounting enforcers meet on a regular basis to discuss enforcement cases and to identify issues that need further coordination or action at European level in order to improve the quality of financial statements. The objective is to contribute to supervisory convergence through the consistent and timely implementation of Community legislation in the Member States. ESMA maintains a database with the relevant enforcement decisions taken by independent EU National Enforcers in respect of financial statements. The purpose of this is to increase convergence amongst enforcers' activities across Europe. The most relevant of these decisions are published on the ESMA website.[102]

Interaction between Regulation 1606/2002 and the Accounting Directive

119. With the adoption of the Regulation 1606/2002 and the subsequent endorsement of individual standards, IFRS have become part of the **acquis communautaire**. The Regulation does not supersede the existing accounting directives which co-exist with the Regulation. However, since the accounting directives apply to companies through their transposition into national law, there is no direct interaction between the accounting directives and the Regulation; only the latter is directly applicable to companies. Specifically, the interaction is one between national law and Regulation 1606/2002.

120. The issue of interaction is only relevant to the extent that a national law deals with the same subject matter as the Regulation. Some aspects of national laws transposed from the accounting directives deal with matters outside the scope of the Regulation and will continue to apply (e.g., the responsibility for the preparation of accounts, the requirement for a statutory audit, the requirement for publication of accounts). In 2003, the EC commented on these matters and clarified the interac-

100 See respectively *http://www.esma.europa.eu/system/files/03_073.pdf* and *http://www.esma.europa.eu/system/files/04_045b.pdf*

101 *http://www.esma.europa.eu/system/files/2014-807_-_final_report_on_esma_guidelines_on_enforcement_of_financial_information.pdf*

102 See *http://www.esma.europa.eu/index.php?page=contenu_groups&id=58&docmore=1#doc*

tion between the directives (as implemented by Member States) and Regulation 1606/2002.[103] The applicability of IFRS for SMEs is further discussed in Chapter IV.B.

iii. Other Relevant Financial Market Directives

121. **Transparency Directive** (2004/109/EC):[104] The Transparency Directive addresses one of the central priorities set out in the FSAP, i.e. the transparency of financial information supplied by issuers whose securities are admitted to trading on a regulated market. It applies to European issuers but also to issuers incorporated in third countries. Regulation 1606/2002 had already paved the way for a convergence of financial reporting standards throughout the EU for those issuers. The Transparency Directive builds on this approach with regard to annual and interim financial reporting. It requires that:

- an issuer shall make public its annual financial report at the latest four months after the end of each financial year; and
- an issuer of shares or debt securities shall make public a half-yearly financial report covering the first six months of the financial year as soon as possible after the end of the relevant period, but at the latest two months thereafter.

122. The annual financial report must include the audited financial statements, the management report including the corporate governance statement, and statements made by the persons responsible within the issuer, whose names and functions must be clearly indicated, to the effect that, to the best of their knowledge, the accounts prepared in accordance with the applicable accounting standards give a true and fair view of the assets, liabilities, financial position and profit or loss of the issuer and the undertakings included in the consolidation taken as a whole.[105] Where the issuer is required to prepare consolidated accounts, the audited financial statements shall be drawn up in accordance with IFRS. Some exceptions are authorized however when accounting standards of the third county where the issuer is established are considered to be equivalent (see paragraph 127).

123. Quarterly financial reporting generated controversial discussions and ultimately a modification of the Transparency Directive in 2013.[106] The initial text of the Directive did not explicitly mandate quarterly information but, based on the experience in the US and in some Member States, it was generally accepted that it would improve investors' protection. Article 6.3 asked the EC to provide a report on this issue by 2010. Although a DG MARKT report of 27 May 2010 was rather positive

103 See *http://ec.europa.eu/internal_market/accounting/docs/ias/200311-comments/ias-200311-comments_en.pdf*
104 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2004L0109:20080320:EN:PDF*
105 Issuers active in the extractive or logging of primary forest industries are required to publish an additional country by country report on payments made to governments.
106 Directive 2013/50/EU of 22 October 2013 OJ-EU L 294, 6.11.2013:
See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32013L0050:EN:NOT*

towards quarterly reporting,[107] another decision was ultimately adopted. In order to reduce the administrative burden and to encourage long term investment, Member States may no longer require quarterly financial information, since the revision of the Directive in 2013. (Article 3.1) The Directive provides however an option under strict conditions, allowing the home Member States to require issuers to publish additional periodic financial information on a more frequent basis. (Article 3.1a) Where the issuer is required to prepare consolidated accounts, the condensed set of financial statements shall be prepared in accordance with IAS 34.

124. The European Commission adopted on 8 March 2007 a Directive laying out detailed rules for the implementation of certain provisions with regard to the harmonization of the transparency requirements prescribed within the original Transparency Directive, such as disclosure of certain voting rights; of the issuer's choice of home Member State; of the condensed set of half-yearly financial statements; and of any major holdings or changes thereto.[108]

125. The Transparency Directive envisages, with effect from 1 January 2020, that all annual financial reports should be prepared in a single electronic reporting format provided that a cost-benefit analysis has been undertaken by the ESMA. The electronic reporting format, with due reference to current and future technological options should be proposed in a draft regulatory technical standards to be submitted by ESMA to the European Commission by the end of 2016 (Article 4.7).

126. **Prospectus Directive** (2003/71/EC):[109] The Prospectus Directive regulates the laws in relation to the drawing up and the publication of prospectuses when securities are offered to the public and/or admitted to trading on a regulated market in the EU. It is a maximum harmonization directive in relation to the contents and format of prospectuses and as such, Member States may not impose disclosure provisions in addition to those required by the Directive. One of the major consequences of the Directive is the "passport", i.e. the ability to raise capital in any of the 28 Member States with the production of a prospectus drawn up and approved in one Member State. This was one of the central priorities set forth in the FSAP in 1999 (see paragraph 36). Directive 2010/73/EU of 24 November 2010 amends the original version of the Prospectus Directive in order to reduce the burdens weighing on companies within the Union to the necessary minimum without compromising the protection of investors and the proper functioning of the securities markets in the Union.

127. The Prospectus Directive requires that issuers include consolidated accounts prepared in conformity with the requirements of Regulation 1606/2002, i.e. endorsed IFRS. Some exceptions are authorized however when accounting standards

107 Paragraph 11, See *http://ec.europa.eu/internal_market/securities/docs/transparency/directive/com-2010-243_en.pdf.* This view was also supported by a majority in the consultation organized by the EC on the modernization of the Transparency Directive (Feedback statement of 17 December 2010 p. 8.2) See *http://ec.europa.eu/internal_market/securities/docs/transparency/transparency-consultation-summary_en.pdf*
108 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:069:0027:0036:EN:PDF*
109 See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0071:20080320:EN:PDF*

of the third country where the issuer of securities is incorporated are considered to be equivalent.

128. **Equivalence mechanisms:** Both the Transparency Directive and the Prospectus Directive establish a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities. The objective is to exempt them from providing reconciliation with IFRS. The mechanism for the determination of equivalence is described in the Commission's Regulation (1569/2007/EC)[110] of 21 December 2007. First, the Regulation defines the meaning of equivalence and the conditions for the acceptance of third country accounting standards for a limited period. The equivalence decision is taken by the EC after consulting with ESMA on the technical aspects of the assessment of equivalence including the convergence program or the progress towards adoption of IFRS.

129. The Generally Accepted Accounting Principles of the USA, Japan, China, Canada, South Korea and India were found to be equivalent to IFRS as adopted by the EU. Issuers established in these countries may use financial statements drawn up in accordance with their local GAAP to provide historical financial information. The decision concerning some of these countries (China, Canada, South Korea, and India) is temporary; authorizations have been given for financial years starting before 1 January 2015.[111] The issue is further discussed in Chapter IV.A.

C. AUDITING: THE ACQUIS COMMUNAUTAIRE AS IT APPLIES TO CORPORATE SECTOR AUDITING

130. In 2006, the European Parliament and European Council issued a new Eighth Directive on statutory audits of annual accounts and consolidated accounts (2006/43/EC)[112] that repealed and replaced the previously existing Eighth Company Law Directive issued in 1984 (the "initial Eighth Directive"). In 2014 this Directive was revised, published in the Official Journal of the EU on 27 May 2014, and a new Audit Regulation was adopted. The revised Directive includes measures to **strengthen the independence of statutory auditors, make the audit report more informative, and strengthen audit supervision throughout the Union**. The Regulation introduces stricter requirements on the statutory audits of public-interest entities, such as listed companies, credit institutions, and insurance undertakings, to reduce risks of excessive familiarity between statutory auditors and their clients, encourage professional skepticism, and limit conflicts of interest. Member States have until 14 June 2016 to implement the revised Directive. The Regulation will also become directly applicable in mid-2016 to ensure that by the time of its application, every Member State will have put in place the provisions necessary to comply with the Directive.

110 OJ-EU L340 of 22.12.2007;
See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:340:0066:0068:EN:PDF*

111 To that purpose, Regulation (EC) n°1569/2007/EC was amended by Regulation 310/2012/EC on 21 December 2011; See *http://ec.europa.eu/finance/accounting/third_countries/index_en.htm*

112 See *http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_157/l_15720060609en00870 107.pdf*

131. The overall objective of the Audit Directive (2006), was to improve and harmonize audit quality and to support public confidence in the statutory audit function. To that end, the Directive set out requirements on (a) education and training, (b) approval and registration of statutory auditors and audit firms, (c) ethical principles and auditor independence, (d) auditing standards, (e) quality assurance, (f) public oversight, (g) the appointment and removal of auditors, and (h) audit committees for public interest entities. In addition, the Directive aimed to improve the functioning of the Internal Market via provisions on recognition of auditors from other Member States and lowering restrictive rules on ownership and management of audit firms. The Directive also promoted regulatory cooperation within the EU, and deals with the approval of auditors from third countries and the registration of audit firms from third countries.

132. Although this Directive was not yet fully operational in all Member States, the European Commission decided to assess its effects in the light of the banking crisis of 2008. A Green Paper "Audit Policy: Lessons from the Crisis" published on 13 0ctober 2010[113] aimed at generating public debate on, among other topics, the role of auditors; governance and independence of audit firms; concentration in the audit market; and how Member States organized oversight of audit firms. One year later, the EC proposed amendments to the Audit Directive (2006) to enhance the single market for statutory audits and a Regulation of public interest entities audits (PIEs). These proposals were heavily debated, notably because they suggested using the legal instrument of a regulation leading to maximum harmonization. Also many competences would have been transferred to the securities regulator ESMA. After two years of discussions and many amendments to the initial proposals, a political agreement was eventually reached and the legislations were published in the Official Journal on 27 May 2014.[114] Amendments to the Audit Directive (2006) need to be transposed into national laws by 17 June 2016. An additional Regulation shall apply from the same day.

Legislative approach

133. The Audit Directive (2014) is a minimum harmonization directive and, as such, Member States are allowed to enact more stringent or additional requirements. However, it prevents spill-over effects from more stringent national regulations in the case of group audits and issuers from other Member States. Furthermore, the Directive supports the idea of home-country control on the basis of mutual recognition of equivalence and promotes close co-operation between Member State regulators. The **Committee of European Auditing Oversight Bodies** (CEAOB),[115]

113 Doc. COM(2010) 561 final;
See *http://ec.europa.eu/internal_market/consultations/docs/2010/audit/green_paper_audit_en.pdf*

114 The Audit Reform includes two pieces of legislation (1) Directive 2014/56/EU of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts – See a consolidated version of the Audit Directive at *http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02006L0043-20140616-*, and (2) Regulation 537/2014/EU of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities – *http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0537*.

115 Until the reform of 2014, cooperation between European audit regulators was facilitated by the European Group of Auditors' Oversight Bodies (EGAOB), which had a less formal status and reduced competences.

established by Article 30 of the Regulation (2014), carries out coordinating tasks in cases provided for in the new Regulation. It will also contribute to the improvement of the cooperation mechanisms regarding oversight of public interest entities' audit firms or the networks they belong to.

134. In line with the principle of proportionality, the Regulation sets out more stringent and/or additional requirements for the statutory audits of PIEs. Areas where stringent rules are determined include, notably, prohibited non-audit services to audit clients, transparency report by audit firms, appointment of statutory auditors and their fees, duration of the engagement, external quality assurance and oversight. The Directive defines PIEs as publicly traded companies, banks, and insurance undertakings. It allows Member States to expand the definition of PIEs.

135. Based on Article 290 TFEU, both the Directive and the Regulation allow the Commission to adopt delegated acts on certain provisions such as auditing standards, ethics and independence, quality assurance and the equivalence of third-country systems of quality assurance, discipline, and public oversight. The procedure involves Member States through the Audit Regulatory Committee and the European Parliament.

Education and Training

136. The new Audit Directive (2014) does not change education and training requirements. The Audit Directive (2006) made few changes to the minimum requirements on education and training as compared to the initial Eighth Directive. The education and training cycle includes university entrance or the equivalent level at the start, the completion of theoretical instruction, three years of practical training, some of which must be with a statutory auditor or audit firm, and a final examination of professional competence equivalent to university degree level (Article 6). The Directive lists the curriculum subject matters for the theoretical instruction, including accounting, auditing, tax, civil, commercial and company law. Furthermore, statutory auditors must undergo continuing education programs in order to maintain their approval and registration.

Approval and Registration of Statutory Auditors and Audit Firms

137. Only persons who have met the qualification requirements and are of good repute can be approved as statutory auditors. They must be registered in an electronically accessible public register before they can conduct statutory audits. Procedures for the approval of statutory auditors who have been approved in other Member States are restricted to the requirement to pass an aptitude test or to complete an adaptation period as defined in the Directive. The CEAOB should seek a convergence of the requirements of the adaptation period and the aptitude test and at least enhance the transparency and predictability of the requirements (Directive – Article 14).

138. The new Audit Directive (2014) also requires the approval and registration of audit firms. Article 3 sets out restrictions on ownership and management of audit firms. Natural persons having the relevant knowledge (or, should Member States decide so, statutory auditors) or other audit firms shall have at least a majority of the

voting rights and represent a majority of members in the administrative or management body. The majority threshold should not exceed 75% in the latter case. This is to ensure that the statutory audits cannot be compromised by other commercial interests or undue influence. The European Commission proposals to remove these restrictions have been rejected by the European Parliament in 2013.

139. Under the initial Eighth Directive, some Member States required these majorities to be in the hands of nationally approved auditors and audit firms, preventing foreign ownership and management of national audit firms. Such restrictions on approval are no longer possible, and Member States must allow statutory auditors or audit firms approved in other Member States to own and manage audit firms in their country.

140. Statutory auditors carrying out an audit on behalf of an audit firm should always be approved and registered in the host Member State. An audit firm which is approved in a Member State is entitled to perform statutory audits in another Member State provided that the key audit partner who carries out the statutory audit on behalf of the audit firm complies with the conditions to be approved in the host Member State.

Ethics and Independence

141. The Audit Directive (2006) included stipulations on professional ethics (public interest, integrity, objectivity and professional competence), independence, and confidentiality/professional secrecy. The provisions of EU law are broadly comparable to the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA). However, in Europe as in other parts of the world, the rules on independence have been heavily debated. Member States have diverging views as to what discretion can be given to the auditor to self-assess, the risks to their independence. Based on the principle of proportionality, the Audit Directive (2014) still provides a general system applicable to all statutory audits but the Audit Regulation (2014) adds a number of restrictions, which will apply to auditors of public interest entities.

142. The new Audit Directive (2014) keeps the independence requirements of the Audit Directive (2006) that built upon the initial Commission's Recommendation on auditor independence,[116] whereby the statutory auditor self-assesses the risks to his independence and applies mitigating safeguards (Article 22). Independence rules apply at least during both the period covered by the financial statements to be audited and the period during which the statutory audit is carried out. Statutory auditors or audit firms may not carry out a statutory audit if their independence is affected by any existing or potential conflict of interests or business or other direct or indirect relationship between the statutory auditor, the audit firm or the network to which the audit firms belongs, and the audited entity.

116 Commission Recommendation of 16 May 2002 "Statutory Auditors' Independence in the EU: A Set of Fundamental Principles" OJ-EU L 191 of 19 July 2002; See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2002:191:0022:0057:FR:PDF*

143. The auditor shall not own financial instruments, hold or have a material and direct beneficial interest in or engage in any transaction in any financial instrument issued, guaranteed, or otherwise supported by any audited entity. Employment by audited entities of former statutory auditors, or of employees of statutory auditors or audit firms, is also restricted as it can represent a risk to the independence of the auditor. In order to mitigate the familiarity risk, the key audit partner must be rotated at least every seven years. The firm will also organize a gradual rotation mechanism with regard to the most senior personnel involved in the statutory audit.

144. The Audit Regulation goes much further by introducing prohibitions of non-audit services. Prohibited services include services that involve playing any part in the management or decision-making process of the audited entity; bookkeeping services; designing and implementing internal control or risk management procedures; valuation services; a number of tax services; legal services; human resources services, etc. Although, the Regulation applies directly to audit firms, the text allows Member States to grant some exceptions to these prohibitions. Where the statutory auditor belongs to a network, no member of such network is allowed to provide any prohibited non-audit services to the audited entity, to its parent undertaking or to its controlled undertakings within the Union.

145. Before accepting or continuing an engagement for a statutory audit of a PIE, a statutory auditor or audit firm shall assess and document his independence and more specifically the compliance with the provision of the Regulation. Annually, the statutory auditor or the audit firm has to submit an additional report to the audit committee including a declaration of independence of partners and managers conducting the statutory audit, and discuss with the audit committee the threats to their independence and the safeguards applied to mitigate those threats. The auditor's assessment of his independence is complimented by other safeguards, such as the audited entity having to disclose in the notes to its financial statements the audit fee and the fees for non-audit services paid to its statutory auditor or audit firm.

Auditing Standards and Audit Report

146. The International Standards on Auditing (ISA) are broadly applied in most EU Member States. Article 26 of the Audit Directive (2006) opened the way for the European Commission to make use of ISA compulsory through a mechanism of adoption similar to what is applied for IFRS. Recital 13 of this Directive states "It is important to ensure consistently high quality in all statutory audits required by Community law. All statutory audits should therefore be carried out on the basis of international auditing standards approved by the Commission." No deadline was set for the Commission to adopt ISA. The Directive as amended in 2014 sets out basic conditions before ISA could be adopted. The issue is further discussed in Chapter IV.D.

147. The proportionality of ISA was heavily debated in the EU and globally. Some auditors argued that their application in smaller undertakings would be difficult and increased costs. Furthermore, in some countries, limited assurance of the accounts of small undertakings have been accepted instead of a statutory audit. Both issues

have been addressed with the Audit Directive (2014) revision, further discussed in Chapter IV.D.

148. The Audit Directives (2006 and 2014) contain a specific provision on international group audits, for which the group auditor should be solely responsible and have appropriate documentation concerning the audit of components in third countries. The Directive prescribes that the individual auditor shall sign the audit report to stipulate his professional accountability.

149. Article 28 of the new Audit Directive defines the structure of the audit reports and the types of audit opinions. It confirms that the report should be prepared in accordance with the requirements of the international auditing standards adopted by the EC. As far as public interest entities are concerned, the Audit Regulation additionally requires, in support of the audit opinion, a description of the most significant assessed risks of material misstatement – including assessed risks of material misstatement due to fraud, a summary of the auditor's response to those risks and, where relevant, key observations arising with respect to those risks.

150. The new auditor report will also include a statement about the auditee's ability to continue as a going concern. Article 25a of the Audit Directive (2014) states very clearly that "Without prejudice to the reporting requirements referred to in Article 28 of this Directive and, where applicable, Articles 10 and 11 of Regulation (…), the scope of the statutory audit shall not include assurance on the future viability of the audited entity or on the efficiency or effectiveness with which the management or administrative body has conducted or will conduct the affairs of the entity." Article 28 2.e, to which it refers, introduces a new and important requirement relating to the ability of an audited company to continue its operations: it requires a statement in the auditor's report on any material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern.

151. The auditor establishes a formal procedure when they suspect, or have reasonable grounds to suspect, irregularities including fraud with regard to the financial statements of the audited entity. The auditor should then "inform the audited entity and invite it to investigate the matter and take appropriate measures to deal with such irregularities and to prevent any recurrence of such irregularities in the future". Where the audited entity does not react properly, the auditor has a duty to inform the authorities. The future role of auditors and auditors' reporting is further discussed in Chapter IV.B.

152. In PIEs, the audit firm shall submit an additional report to the audit committee of the audited entity. The Audit Regulation (2014) defines the content of this report which is intended to cover, among other elements listed in Article 11, audit methodology, significant deficiencies in the internal financial control system, events or conditions identified in the course of the audit that may cast significant doubt on the entity's ability to continue as a going concern, actual or suspected non-compliance with laws and regulations, assessment of valuation methods and aspects of ethics.

Internal Organization of Audit Firms and Quality Assurance

153. The International Quality Control Standards (ISQC1) issued by the IAASB requires audit firms to comply with a number of principles of good governance. Article 24a of the Directive as amended in 2014 inserts most of these principles in the EU legislation. The scale and complexity of the firm's activities can influence the compliance with these requirements but the statutory auditor or the firm should be able to demonstrate to the competent authority that such policies and procedures designed to achieve compliance are appropriate. To this end, Article 24b imposes extensive documentation requirements.

154. Audit firms that audit PIEs must present an annual transparency report with information on the firm's (a) legal structure, (b) governance and ownership, (c) network arrangements, (d) systems of internal quality control, and (e) basis of partners' remuneration.

155. Internal quality assurance must be supplemented by a system of external independent quality assurance covering all statutory auditors and audit firms. The Directive defines the scope of the quality review/inspection as an assessment of compliance with auditing standards and independence requirements. Member States are required to establish a system that is independent from the reviewed statutory auditors and audit firms; has secure and independent funding; has sufficient resources; is of sufficient quality; and is submitted to public oversight. Quality assurance must take place at least every six years (every three years for statutory audits of public interest entities), with the overall results being published annually and, where needed, followed up on.

156. When carrying out quality assurance reviews of the statutory audits of annual or consolidated financial statements of medium-sized and small undertakings, reviewers should always consider that the auditing standards are designed to be applied in a manner that is proportionate to the scale and complexity of the business audited entity. Article 29 of the Directive as amended in 2014 invites Competent Authorities to remember this principle in order to apply quality assurance procedures proportionally.

157. Conversely, the principles of quality assurance for PIEs are reinforced by the Audit Regulation 2014. On the one hand a provision of the Audit Directive requires that an engagement quality control review be performed to assess whether the auditor could reasonably have come to the opinion and conclusions expressed in the draft audit report. On the other hand, the external quality control is strengthened. Several rules are taken over from the Commission's Recommendation (2008/362/EC) of 6 May 2008 the on external quality assurance for statutory auditors and audit firms auditing public interest entities.[117] Detailed guidance is given on the independence of reviewers but also on the scope of inspections on reporting and recommendations to auditors and audit firms.

[117] See *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:120:0020:0024:EN:PDF*

System of Public Oversight

158. Each Member State must establish an effective system of public oversight. This means that the body (ies) involved should be governed by a majority of non-practitioners knowledgeable in areas relevant to statutory audit but independent from statutory auditors and audit firms. The Member States are responsible for designating the Competent Authorities to carry out the duty of public oversight. The European Commission publishes a list of the Competent Authorities in charge of public oversight activities in the Member States.[118]

159. Two different models of public oversight co-exist: a direct oversight of statutory auditors and audit firms by an independent (public) body, and an indirect system of oversight where an independent (public) body(ies) has the ultimate oversight responsibility but can delegate some of these responsibilities to professional or other bodies. In 2006, the indirect model was adopted in the EU. Article 32.4 of the Directive provides that "The system of public oversight shall have the ultimate responsibility for the oversight of (a) the approval and registration of statutory auditors and audit firms, (b) the adoption of standards on professional ethics, internal quality control of audit firms and auditing, and (c) continuing education, quality assurance, and investigative and disciplinary systems."

160. The legislative reform of 2014 adopts a mixed approach: As suggested by the EC communication on quality assurance (see above paragraph 153), the oversight of firms auditing public interest entities would become a direct system, prohibiting most delegations to professional bodies, in particular external quality review (Article 38a of the Audit Regulation 2014). However delegations would remain possible notably for the oversight of other statutory auditors and audit firms.

161. Supervision of audit networks and audit firms that have cross-border activities requires the public oversight authorities of the Member States to exchange information and to coordinate their operations at EU level and with third countries. The **CEAOB** established by the Audit Regulation (2014) (see paragraph 133) will be responsible for coordinating tasks and improving the cooperation between oversight Bodies in the EU and globally.

Appointment and Dismissal of auditors – role of audit committees in PIEs

162. In order to keep a sufficient arm's length distance between the management of the company and the auditor, the auditor must be appointed by the general meeting of shareholders. The statutory auditor or audit firm cannot be directly selected by the management. The Directive also specifies that the dismissal of auditors during their mandate can be done only on proper grounds and must be communicated to the public oversight authority.

163. PIEs must have an audit committee with specified tasks such as monitoring the financial reporting process and statutory audit. The audit committee is an important

118 See *http://ec.europa.eu/internal_market/auditing/docs/dir/100201_competent_authorities_SAD_en.pdf*

element for safeguarding audit quality and auditor independence, and it is involved in the selection of the auditor. The statutory auditor must report to the audit committee on key matters arising during the audit and on independence issues. The Directive provides several exemptions from the audit committee requirement, such as for subsidiaries and investment undertakings.

164. One of the objectives of the legislative reform of 2014 was to improve market conditions. To that end and as far as PIEs are concerned, several provisions of the Audit Regulation establish rules on the appointment of audit firms, the tender procedures, the role of audit committees in the selection procedures and the maximum duration of the engagement (rotation of audit firms).

Approval and Registration of Third-country Auditors and Audit Firms

165. Competent authorities of Member States may approve third-country auditors as statutory auditors. These third-country auditors are subject to the same approval procedure as Member State auditors wishing to carry out audits in a second Member State, mandating good repute as well as the above mentioned educational requirements (see paragraph 137).

166. Third-country (i.e., non-EU) auditors and audit firms are equally subject to registration where they audit a company which has equity and/or debt traded on an EU Member State regulated market. This may be waived in some cases with regard to debt securities traded by professional investors. Registered third-country auditors and firms will be subject to the same systems of oversight, quality assurance, and investigation and penalty systems as their EU equivalents. Third-country auditors and auditing entities may be exempted from these requirements if their domestic system has been deemed as equivalent to the EU system with respect to public oversight, quality assurance, investigations and penalties. The Audit Directive also sets out procedures of cooperation with competent authorities from third-countries, as regards working arrangements and the transfer of working papers or other documents.

4. A Look Forward

167. The EU has made great strides in harmonizing corporate sector accounting and auditing within its Member States, resulting in the adoption of the 2014 Audit Directive and Regulation, and 2013 Accounting Directive. After this period of intense activity, and once the legislation has been implemented by Member States, a period of relative stability is expected, although a number of policy and implementation issues will require ongoing attention. These include: (A) endorsing and using IFRS in the EU; (B) enhancing auditors' reporting; (C) financial reporting for SMEs; (D) auditing and other assurance for SMEs; (E) adopting International Standards on Auditing (ISA); and (F) strengthening audit oversight systems.

A. ENDORSING AND USING IFRS IN THE EU

168. The adoption and harmonization of financial reporting standards is an issue of ongoing relevance. IFRS are currently mandatory only for consolidated financial statements of companies whose securities are issued on regulated markets, but companies can choose to have their Individual financial statements prepared under IFRS. The 2013 Maystadt Report confirmed that "IFRS are the best choice at the moment … " but recommended some improvements to the IFRS adoption criteria, and substantial changes in the governance of EFRAG, now underway, to better involve national standard setters in the decision-making process and enhance the EU's role in international accounting standard setting. Consideration of how IFRS might be applied, and the principles under which IFRS are endorsed, in the EU is still ongoing. Progress is expected following a Commission public consultation in 2014 to evaluate the effectiveness of the IAS Regulation and better understand: (i) the impact of using IFRS in the EU, (ii) how far IFRS have met the initial objectives of the IAS Regulation, (iii) whether these objectives are still relevant, and identify areas for improvement.

169. Work towards adoption of a global set of accounting standards, and ensuring their consistent application, will continue to be of interest. Responses to a 2011 IASB consultation paper suggested that, after a period dominated by convergence projects, there was now greater interest in addressing matters related to the practical application of IFRS.[119] Consistent application is a concern for securities supervisors in

[119] See above mentioned IASB Feedback statement, p. 6

countries applying IFRS and in the US.[120] In its consultation paper on the revision of the CESR Standard n°2 on enforcement (see para. 118), ESMA considered the need for a common European approach to achieve a proper and rigorous enforcement regime to underpin investors' confidence in financial markets and avoid regulatory arbitrage by issuers in the EU Single Market: "The objective of enforcement of financial information included in harmonized documents is to contribute to a consistent application of the relevant reporting framework".[121]

B. ENHANCING AUDITORS' REPORTING

170. New audit reporting requirements will significantly impact the role of auditing for PIEs. Audit Regulation requirements on the content of the audit report for PIEs, as well as those introduced by the IAASB in the ISA, will change the way auditors communicate on audits with shareholders, audit committees, and regulators. Benefits will include a better understanding of the work performed by statutory auditors on financial statements and related information in the management report and of their view on the going concern of the audit company, role in detecting and preventing fraud, and a clearer understanding of the state of their independence vis-a-vis their clients. Successful implementation of these modifications will depend on the diligence of audit and securities regulators and audit firms, especially those in international networks. The risk is that auditors either use boiler-plate language to avoid undue exposure to legal liability, or audit report practices become too diverse. The securities and the markets regulators face the difficult challenges of monitoring the quality of the new audit reports and, for PIE audits, ensuring consistent quality in auditors' reports and effective communication on specific issues.

171. The auditor is now expected to include an opinion in his report concerning non-financial information, more broadly all information included in the management report. Article 34 of the Accounting Directive (2013) requires the auditor to state whether the management report is consistent with the financial statements for the same financial year, and whether the management report has been prepared in accordance with the applicable legal requirements. Considering the growing number of disclosures to be provided by management in their report, this reflects a significant increase in auditors' responsibilities. It remains unclear whether the auditor must always express a formal opinion, or only when there is a specific observation on how management reported.

120 In April 2004, CESR issued its Standard no. 2 on Financial Information – Coordination of Enforcement aiming at achieving the necessary coordination and convergence of enforcement activities carried out by EU National Enforcers. *http://www.esma.europa.eu/system/files/03_317c.pdf*; A similar concern is expressed in the US-SEC Staff Report on IRSs of 13 July 2012 (p.15)
See *http://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-final-report.pdf*

121 Guidelines on enforcement of financial information – Consultation Paper 19 July 2013, paragraph. 1 –
See *http://www.esma.europa.eu/system/files/2013-1013_consultation_paper_-_guidelines_on_enforcement_of_financial_information.pdf*

172. The communication between auditors and supervisors should be enhanced as a consequence of the new Regulation. Mechanisms for this communication will need to be further defined by national regulators. Article 12 of the Audit Regulation requires that an effective dialogue be established between the competent authorities supervising credit institutions and insurance undertakings and the statutory auditor(s) and audit firm(s) carrying out the statutory audit of those institutions and undertakings. The auditor has a duty to report promptly to the competent authorities supervising the PIE or the audit firm itself, any information of which he has become aware while carrying out that statutory audit concerning (a) material breach of the laws, regulations or administrative provisions governing the PIE, (b) a material threat or doubt concerning the possibility to continue as a going concern, and (c) the qualified opinion, adverse opinion or disclaimer that the auditor intends to issue.

C. FINANCIAL REPORTING FOR SMEs

173. The EU focus on SMEs, reflected in efforts to simplify financial reporting requirements contained in the 2013 Accounting Directive, will continue. One option available to Member States is the introduction of a new category of micro-entities, with minimum reporting requirements. Using a building-blocks approach, the Directive increases requirements for financial statements and other disclosures gradually, depending on the size of the undertaking. This allows small companies to draw up abridged accounts and notes to the accounts, and gives exemption from the requirement for a statutory audit as well as from drawing up an annual report. Member States can also choose to allow medium-sized companies to adopt a different layout for the profit and loss account, to present aggregate balance sheet information, not to draw up consolidated accounts, and to exclude non-financial information from the annual report.

174. Although not an option under the Accounting Directive, there is potential for the simplified IFRS for SMEs standard to serve as a basis for credible national accounting systems for medium-sized companies. Several EU Member States expressed their interest in IFRS for SMEs when they were launched by the IASB 2009 though none yet use them. A European Commission public consultation on their use in the EU elicited no clear response.[122] In the UK and Republic of Ireland, a standard applicable to medium-sized and large entities not applying IFRS is based on the IFRS for SMEs, but with significant modifications (FRS 102). Denmark, Hungary and the Netherlands are considering allowing some entities to apply IFRS for SMEs. While the 2013 Accounting Directive does not refer directly to the IFRS for SMEs, EFRAG concluded, in a 2010 study commissioned by the EC,[123] that there were very few inconsistencies between the EU Accounting Directives and IFRS for SMEs that would prevent a Member State requiring/allowing this standard to be applied for companies

122 See *http://ec.europa.eu/finance/accounting/sme_accounting/index_en.htm*

123 EFRAG Compatibility Analysis: IFRS for SMEs and the EU Accounting Directives of 3 June 2010, *http://www.efrag.org/news/detail.asp?id=548*

falling outside the scope of Regulation 1606/2002. The 2013 Accounting Directive reduces these differences further, bringing them down potentially to one of a temporary nature related to unpaid capital, with the use of the right Member State options.

D. AUDITING AND OTHER ASSURANCE FOR SMEs

175. The 2014 Directive requires Member States to ensure that auditing standards are applied in a manner that is proportionate to the scale and complexity of the business of the entity. The applicability of ISA to medium-sized or other non-listed undertakings has been widely discussed in Europe because of the costs of compliance and of keeping the required documentation. Professional bodies could be required by Member States to provide further guidance on the proportionate application of auditing standards to medium-sized companies. Competent authorities need to take account of the proportionate application of the standards when undertaking quality assurance reviews and in relation to inspections (Article 29.3).

176. Review engagements for small companies may be a good alternative to obtain some assurance on small companies' financial statements without having to bear the cost and the complexity of an audit. Although the proportionality of ISA is now broadly recognized, expectations of small businesses application of the audit process have differed. The Fourth Directive in 1978 did not require small companies' annual accounts to be audited but some Member States nevertheless imposed this. Some Member States such as Lithuania and Estonia, require limited review engagement for small companies but not statutory audits, providing a limited assurance which reduces the risk to an acceptable level in the circumstances of the engagement.[124] The European Parliament's Committee on Legal Affairs considered formally recognizing the usefulness of limited assurance engagements for the accounts of small undertakings, instead of a statutory audit. The final text of the 2014 Audit Directive and Regulation do not refer to limited assurance engagements, but they remain a voluntary option for small companies.

124 IAASB, "ISAE 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information" December 2013;
See *http://www.ifac.org/sites/default/files/publications/files/ISAE%203000%20Revised%20-%20for%20IAASB.pdf*

E. ADOPTING INTERNATIONAL STANDARDS ON AUDITING (ISA)

177. A key change to the Audit Directive (2014) is that "Member States shall require that statutory auditors and audit firms comply with international auditing standards adopted" by the Commission, although no target date is set for adoption. The previous legislation allowed, but did not require, the European Commission to adopt ISA for statutory audits of annual and consolidated accounts.

178. European Commission research concluded that, "on balance, an adoption of the clarified ISA through the EU would contribute to the credibility and quality of financial statements and to audit quality in the EU, and to a greater acceptance of audit reports outside of their home jurisdictions within and outside of the EU. There are significant net benefits expected from ISA adoption through the EU".[125] A public consultation revealed an overwhelming majority in favor of adoption of ISA at EU level.[126]

179. Article 26.3 of the Audit Directive (2014) sets out preconditions for ISA to be adopted, i.e., whether the standards (1) have been developed with proper due care, in a transparent manner, under public oversight and are generally accepted internationally; (2) contribute to a high level of credibility and quality of the annual and consolidated financial statements; (3) are conducive to the Union public good; and (4) do not amend or supplement the Directive (however some exceptions are foreseen to this last condition). It is relevant to note that the adoption of ISA requires translation into each of the 23 official languages of the EU and publication in full in the Official Journal of the EU. Where the Commission has not endorsed an ISA covering a specific subject, EU Member States are allowed to apply their national auditing standards. However, once an ISA is endorsed, statutory audits must be conducted in accordance with the endorsed ISA. Member States may add audit procedures or requirements to ISA only if those audit procedures or requirements stem from specific national legal requirements relating to the scope of statutory audits.

180. The adoption of ISA will now result from a "delegated act" as defined by Article 290 TFEU. The Commission will determine whether the ISA meet the requirements set in Article 26.3, assisted by a Committee of Member States representatives. The delegated act enters into force if there are no objections from the European Parliament or the Council within 4 months (extension is possible to 6 months) of notification of the act. The delegation can be revoked at any time. The delegation is time limited to 5 years after the entry into force of the Directive (Article 48a). After this period the Commission will report on how it used the delegated powers and the delegation will be extended for 5 additional years, unless opposed by the European Parliament or the Council.

125 See *http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/summary_en.pdf*
126 See *http://ec.europa.eu/internal_market/auditing/docs/isa/isa-final_en.pdf*

F. STRENGTHENING AUDIT OVERSIGHT SYSTEMS

181. The Audit Regulation represents a major step towards harmonization across the EU of public oversight and quality assurance systems of significant audits. Implementation of the Regulation will require additional funding to further develop the operational capacity of oversight and quality assurance systems of PIEs as the Regulation (see paras. 153-156) forbids the delegation of the following tasks: (i) the quality assurance system, (ii) investigation referred to in article 23 of the Regulation and article 32 of the Directive arising from that quality assurance system or from a referral by another authority, and (iii) sanctions and measures related to the quality assurance reviews or investigation of statutory audits of PIEs.

182. National legislators need to decide whether the public oversight system will only review PIEs engagements, in which case the professional body will continue inspecting the same audit firms to cover non-PIEs, or have just one institution undertaking both inspections. More robust public oversight systems require more and new resources. Various funding mechanisms co-exist in the EU today, from Government funding to levies imposed on statutory auditors and audit firms. Funding mechanisms will need to provide enough funds to enable effective oversight while preserving independence from the audit profession.

183. Identifying, attracting, and retaining competent staff, with appropriate local knowledge, to operate the quality assurance of PIEs audit remains a challenge. The competence of these individuals is generally correlated with their professional audit experience, often with international audit network firms. Public oversight authorities must be able to offer salary and benefit packages that are competitive with the ones offered by these firms. Additionally, the salaries of the staff that work for public oversight institutions may be constrained by government pay scale in some countries; some Member States have established their public oversight systems as independent agencies to bypass this issue.

184. Increased cooperation across Europe will be necessary as public oversight systems build up their operations and skills to fulfill their new responsibilities. This cooperation also makes sense given the number of PIEs audits operated internationally. While the quality assurance system should respect the principle of home country regulation and oversight by the Member State in which the statutory auditor or the audit firm is registered, a future option could be to have quality assurance teams review audits at EU level, replicating the system put in place for banking supervision by the European Central Bank for systemic banks. The CEAOB will coordinate tasks and improve cooperation between oversight Bodies in the EU and globally and be a forum to allow peer institutions to share their experience and support each other. At international level, the International Forum of Independent Audit Regulators (IFIAR) is playing this important role of sharing knowledge among peers and organizing training for audit supervisory bodies.

Annex: Timeline

Year	Enlargements	A&A LegislationCompany		Treaties
1950				
				1952 Treaty of Paris » European Coal and Steel Community (ECSC)
	1957 Original 6 countries: Germany, France, Luxembourg, Belgium, Italy, Netherlands			1957 Treaty of Rome » European Economic Community (EEC) » Euratom » Legal Basis for company law harmonization » Consultation Procedure
1960				
		1968 1^{st} Company Law Directive	Company law harmonization	
1970				
	1973 Denmark, Ireland, United Kingdom accede			
		1978 4^{th} Company Law Directive		
1980				
	1981 Greece accedes			
		1983 7^{th} Company Law Directive		
		1984 8^{th} Old Company Law Directive on Audit		
	1986 Spain, Portugal accede	1986 Company Law Directive on Banking		
				1987 Single European Act: » Internal Market » Cooperation Procedure
1990				
		1991 Company Law Directive on Insurance Undertakings		
				1992 Treaty on European Union (Maastricht): » European Community(EC) » Introduced Co-decision procedures » Introduced Subsidiarity Principle » Euro as common currency
	1995 Austria, Finland, Sweden accede	1995 IAS communication	Capital market and internationalization	
				1997 Treaty of Amsterdam » Strengthened the role of European Parliament
2000				
		2002 Regulation 1606/2002		2002 Treaty of Nice, Enlargement Treaties
	2004 Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic, Slovenia accede			2004 European Constitution (not ratified)
		2005 Directive updating the 4^{th} and the 7^{th} Company Law Directives		
		2006 New 8^{th} Company Law Directives		
	2007 Bulgaria, Romania accede			2007 Treaty of Lisbon » Amended EU and EC Legislation » Strengthened the role of European Parliament
2010				
	2013 Croatia accedes	2013 New Accounting Directive		
		2014 Amendment to Audit Directive and Regulation		

Table of Acronyms

ARC	Accounting Regulatory Committee
AuRC	Audit Regulatory Committee
CEAOB	Committee of European Audit Oversight Bodies
CEBS	Committee of European Banking Supervisors (EBA since 1 January 2011)
CEIOPS	Committee of European Insurance and Occupational Pension Supervisors (EIOPA since 1 January 2011)
CESR	Committee of European Securities Regulators (ESMA since 1 January 2011)
CFRR	Centre for Financial Reporting Reform
CLAP	Company Law Action Plan
COREPER	Committee of Permanent Representatives (part of the Council of the European Union)
Council	Council of the European Union
DG	Directorate General
DG MARKT	Directorate General for Internal Market and Services
EaP	Eastern Partnership
EBA	European Banking Authority (before 1 January 2011 CEBS)
EC	European Commission
ECJ	European Court of Justice
ECON	Committee on Economic and Monetary Affairs
ECSC	European Coal and Steel Community
EEA	European Economic Area
EEC	European Economic Community
EFRAG	European Financial Reporting Advisory Group
EIOPA	European Insurance and Occupational Pensions Authority (CEIOPS before 1 January 2011)
ENP	European Neighbourhood Policy
ESMA	European Securities and Markets Authority (CESR before 1 January 2011)
EU	European Union
FEE	Fédération des Experts Comptables Européens/Federation of European Accountants (representative organization for the accountancy profession in Europe)
FSAP	Financial Services Action Plan
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards

IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee transformed into IASB in 2001
IFAC	International Federation of Accountants
IFIAR	International Forum of Independent Audit Regulators
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
MEP	Member of the European Parliament
SAP	Stability and Association Process
SEA	Single European Act
SEC	US Securities and Exchange Commission
SME	Small and Medium Enterprises
SSM	Single Supervisory Mechanism
SRM	Single Resolution Mechanism
TEG	Technical Expert Group of EFRAG
TFEU	Treaty on the functioning of the European Union
U.S. GAAP	United States Generally Accepted Accounting Principles

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