4th edition

Corporate Sector Financial and Sustainability Accounting, Reporting, and Auditing in the EU Acquis Communautaire

CFRR
Centre for Financial and Sustainability Reporting Reform
WORLD BANK GROUP

REPARIS FOR SMEs

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Contents

Abbreviations

CEAOB	Committee of European Audit Oversight Bodies
CSRD	Corporate Sustainability Reporting Directive
CFRR	Centre for Financial and Sustainability Reporting Reform
COREP	EBA-issued Common Reporting Standards
EBA	European Banking Authority
ECB	European Central Bank
ECJ	European Court of Justice
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
ESRS	European Sustainability Reporting Standards
EU	European Union
FINREP	EBA-issued Financial Reporting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
LCE	Less Complex Entity
MEP	Member of the European Parliament
NFRD	Non-Financial Reporting Directive
SME	Small and Medium Enterprises
TFEU	Treaty on the Functioning of the European Union
US	United States of America
VSME	Voluntary Sustainability Reporting Standard for non-listed SMEs
WeBa	Western Balkans

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 Federation of European Accountants, updated the Guide as part of the second edition published in 2011. The third edition was revised by Henri Olivier and Pascal Frerejacque (CFRR) and published in 2015.

For this fourth edition encompassing also sustainability reporting, Ranjan Ganguli (CFRR) revised the text with inputs from CFRR colleagues, primarily Andrei Busuioc, Iwona Warzecha, and Svetlana Platon, and with the editorial assistance of Susan Schroeder and graphic design of Kora Reichardt, under the direction of Fabian Seiderer, Institutions Manager. The guide benefited from peer reviewers' comments provided by World Bank colleagues Dmitri Garfunkel and Arun Manuja, and colleagues at Accountancy Europe. Special acknowledgements are owed to Hilde Blomme, Deputy CEO, Paul Gisby, Senior Director Professional Services, and Johan Barros, Director Advocacy & Policy, Accountancy Europe who provided very diligent comments in technical and regulatory matters. We are very grateful for their time and contribution to this guide.

The key elements of the ***acquis communautaire*** in the areas of corporate sector accounting and auditing are accessible on European Commission website.[1]

1 https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing_en

Disclaimer

This Guide is intended to provide a general overview of the relevant sections of the *acquis communautaire* on corporate sector financial reporting, sustainability 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. Gap assessments are done through the Audit and Accounting Reports on the Observance of Standards and Codes (ROSC) conducted by the CFRR. 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 World Bank Centre for Financial and Sustainability Reporting Reform (CFRR), located in Vienna, Austria, supports countries in the Europe and Central Asia region to strengthen private and public sector financial and sustainability reporting and auditing. As part of the World Bank's Institutions Global Department, the CFRR 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 skills 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 financial and sustainability 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. Tools used by the CFRR to inform and support client country reforms include **Reports on the Observance of Standards and Codes (ROSC) on Accounting and Auditing**. These provide a detailed analysis of the extent to which national accounting, reporting, and audit systems comply with international good practice, and the capacity of institutions to implement and enforce such systems. The reports provide recommendations which national governments can use to help develop and assess legislative reform and which guide CFRR's engagement.

The CFRR also manages a range of regional and country-specific programs focused on improving financial and sustainability reporting including: **The Road to Europe: Program of Accounting Reform and Institutional Strengthening for Small and Medium Enterprises – REPARIS for SMEs**. Funded by the European Union as part of the Western Balkans Enterprise Development and Innovation Facility, the Program aims to support: (i) further improvement of access of SMEs in the Western Balkans to professional accounting and financial management services, and (ii) alignment of Western Balkans corporate financial reporting frameworks with relevant European Union directives and regulations.

www.worldbank.org/cfrr

Introduction

The CFRR is pleased to present the fourth edition of its guide to Corporate Sector Financial and Sustainability Accounting, Reporting, and Auditing in the Acquis Communautaire. It aims to give an overview of European Union (EU) policy in this area for policymakers, regulators, and other stakeholders in Member States, enlargement countries, countries within the "European Neighborhood", and other countries interested in understanding the EU standards and regulatory model.

Many of the countries working with the CFRR aim to deepen their relations and integration with the EU. Five Western Balkan countries, Moldova, and Ukraine were granted country candidate status in 2022 to begin formal negotiations for accession to the Union. The EU has also launched the new Western Balkan Growth Plan to deepen economic integration with the EU. This requires significant regulatory and institutional convergence, notably in the area of corporate financial and sustainability reporting and auditing, which the CFRR is supporting, including through this guide.

For CFRR client countries, especially those working towards closer alignment with the EU, this guide offers an overview of the main policies and legislation relevant for their corporate financial and sustainability reporting reforms and practices. It summarizes the EU corporate financial reporting framework and includes for the first time the 2022 Corporate Sustainability Reporting Directive, which stems from the EU's Green Deal and ensures that sustainability reporting and financial reporting become of equal importance and more integrated. Large companies and state-owned enterprises will be required to report on sustainability in accordance with 12 mandatory European Sustainability Reporting Standards from January 1, 2025. The EU is the first large economic block to introduce such advanced and mandatory sustainability reporting and assurance, while rolling it out progressively and seeking further simplifications to enable effective implementation and reducing compliance costs.

The guide also reviews the European Commission's most recent reflections on financial reporting and suggests the likely direction of travel in terms of further development of accounting, auditing, and sustainability reporting. Looking ahead, the Competitiveness Compass presented by the Commission in January 2025, its new roadmap to restore Europe's dynamism and boost economic growth, could also lead to significant changes in terms of: harmonizing EU-wide rules and simplifying corporate, insolvency, labor, and tax law; reducing the regulatory and reporting burden by 25%-35%, including in respect of financial reporting; moving to digital formats based on standardized data to provide a seamless environment for companies to interact with all public administrations; making standard-setting processes faster and more accessible; and integrating and deepening ever more liquid capital markets. These initiatives would greatly impact corporate sector sustainability reporting and auditing frameworks. Indeed, as promised in their presentation of the Competitiveness Compass, the Commission adopted a new package of detailed proposals in February 2025 to simplify rules including on sustainable finance reporting and EU taxonomy for consideration by the European Parliament and Council. Once changes in the sustainability reporting requirements are officially adopted this guide will be updated accordingly.

I hope you find the guide useful. The CFRR remains ready to offer client countries specific advisory and technical assistance, including through its regional programs such as REPARIS for SMEs, to support institutional convergence and deeper economic integration with the EU single market and its supply chains for more and better jobs.

Fabian Seiderer
Manager, Institutions Global Department, World Bank

March 2025

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Overview of EU institutions, regulators, and legislation relating to accounting, sustainability reporting, and auditing

1. The EU is established in a number of treaties, which in turn created the institutional bodies and the body of EU laws known collectively as the *acquis communautaire* (EU acquis) – see Annex for further detail. All new Member States must comply with the EU acquis, although they may be granted transition periods for implementation. For enlargement negotiations, the EU 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.

2. This section provides an overview of EU policy relevant to the area of corporate financial and sustainability reporting.

A. EU institutions with primary responsibility for corporate sector accounting, sustainability reporting, and auditing

3. The Directorate General for Financial Stability, Financial Services, and Capital Market Union[2] is responsible for the EU Single Market's Capital Markets Union and financial

2 See https://commission.europa.eu/about-european-commission/departments-and-executive-agencies/financial-stability-financial-services-and-capital-markets-union_en

markets' objective,[3] which includes company financial reporting and statutory audit. The free movement of professionals throughout the EU is the responsibility of the Directorate General for Internal Market, Industry, Entrepreneurship, and SMEs,[4] which also plays an important role in enhancing the single market by developing policies, laws, and regulations for specific industries and SMEs. The harmonization of company law is a competence of the Directorate General for Justice and Consumers.[5]

4. The European Parliament's Committee on Economic and Monetary Affairs[6] and Committee on Legal Affairs[7] share responsibility for: the regulation and supervision of financial services, institutions, and markets including financial reporting, auditing, accounting rules, corporate governance, and company law matters specifically concerning financial services.

5. The European Securities and Markets Authority (ESMA,) one of the three European Supervisory Authorities within the European System of Financial Supervision that became operational on January 1, 2011, has a supervisory remit over both corporate financial reporting and auditing. See paragraph 14 for more details.

6. The Committee of European Auditing Oversight Bodies (CEAOB) is the framework organization for co-operation between national audit oversight bodies at EU level. Its main objectives are to foster convergence of practice by European audit regulators and the improvement of audit quality. See paragraph 19 for more details.

B. The EU single market

7. An important EU objective is the creation of a single market comprising the free movement of goods, capital, services, and people. While the free movement of goods and capital progressed fast, the free movement of services and people came later and more gradually given the additional complexity and sensitivities. The EU has launched a number of strategies and action plans to increase efforts toward its completion. The following paragraphs include those most relevant to corporate sector accounting, sustainability reporting, and auditing frameworks.

8. In September 2015, the European Commission released an **Action Plan on Building a Capital Markets Union**,[8] which aimed to lower costs of borrowing, increase start-up financing, and broaden the investor base to improve access finance to modernize and expand. In relation to corporate sector accounting and auditing, it noted that additional reporting requirements were a challenge for SMEs trying to list on public market exchanges. The Commission undertook to explore a solution with the International Accounting Standards Board (IASB).

3 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets_en

4 See https://commission.europa.eu/about-european-commission/departments-and-executive-agencies/internal-market-industry-entrepreneurship-and-smes_en

5 See https://commission.europa.eu/about-european-commission/departments-and-executive-agencies/justice-and-consumers_en

6 See https://www.europarl.europa.eu/committees/en/econ/home/highlights

7 See https://www.europarl.europa.eu/committees/en/juri/home/highlights

8 See https://finance.ec.europa.eu/publications/action-plan-building-capital-markets-union_en and https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC0468

9. In October 2015, the Commission presented a new **Single Market Strategy** with the aim of delivering a deeper and fairer single market to benefit consumers and businesses.[9] It undertook to improve access to, and the exercise of, regulated professions at national level and across the EU.

10. In September 2020, the Commission adopted a new **Capital Markets Union Action Plan**,[10] to support a green, inclusive, and resilient economic recovery; make the EU an even safer place to save and invest long-term; and integrate national capital markets into a genuine single market. It sought the adoption of a European single access point providing seamless, EU-wide access to all relevant information (including financial and sustainability-related information) disclosed to the public by companies, including financial companies.[11] It also undertook to consider further simplification of the listing rules for public markets (both SME growth markets and regulated markets) and to work towards an enhanced single rulebook for capital markets by assessing the need for further harmonization of EU rules and monitoring progress towards supervisory convergence.

11. In 2023, the Commission reaffirmed its belief in EU enlargement including full EU membership for Western Balkan countries,[12] and proposed a new **WeBa Growth Plan** to deepen access to and economic integration with the EU and bring forward some EU membership benefits. This does require alignment with the single market rules (see paragraph 153 below).

12. In January 2025, the Commission presented the **Competitiveness Compass**[13] that seeks to boost EU competitiveness by closing the innovation gap; a joint strategy for decarbonization and competitiveness; and increasing security and reducing excessive dependencies. A related package of detailed proposals (see paragraphs 146 and 154-156 below) to simplify rules including on sustainable finance reporting and EU taxonomy have been adopted for consideration by the European Parliament and Council.[14]

C. Financial services regulation and supervision

13. In response to financial turbulence and corporate scandals, the European System of Financial Supervision[15] was introduced in 2011 as the framework for the supervision of the entire financial system of the EU including both eurozone and non-eurozone EU Member States. It consists of the European Systemic Risk Board,[16] which monitors systemic risks and performs macro-prudential oversight, and three European Supervisory

9 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0550 and https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015SC0202

10 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/what-capital-markets-union_en and https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan_en

11 See https://finance.ec.europa.eu/publications/capital-markets-union-commission-adopts-package-ensure-better-data-access-and-revamped-investment_en and https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/what-capital-markets-union_en

12 The six countries of the Western Balkans comprise: Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, and Serbia.

13 See press release announcing the EU Competitive Compass https://ec.europa.eu/commission/presscorner/detail/en/ip_25_339

14 See EC press release at https://ec.europa.eu/commission/presscorner/detail/en/ip_25_614

15 See https://finance.ec.europa.eu/regulation-and-supervision/european-system-financial-supervision_en

16 See https://www.esrb.europa.eu/home/html/index.en.html

Authorities that perform micro-prudential supervision (the European Banking Authority[17] (EBA) – safeguarding the integrity and robustness of the EU banking sector; the European Insurance and Occupational Pensions Authority[18] (EIOPA) – fostering financial stability and confidence in the EU's insurance and pensions markets; and ESMA).[19]

14. ESMA is the EU's financial markets regulator and supervision with a mission to enhance: (i) investor protection to better serve financial consumers' needs and to reinforce their ability to make informed choices, (ii) orderly markets to foster the integrity, transparency, efficiency, and functioning of financial markets and market infrastructures, (iii) financial stability to strengthen the financial system to be capable of withstanding shocks and the unravelling of financial imbalances. ESMA achieves its mission through active co-operation with national and other EU authorities to ensure the most effective and convergent regulation and supervision of EU financial markets as a whole. ESMA, through its membership of the CEAOB, fosters convergence in the practice of European audit regulators and the improvement of audit quality in Europe in order to further trust in informative, reliable, and independent audit reports.

15. All European Supervisory Authorities have considerably stronger powers than the agencies they replaced. The earlier framework was based on directives, which left room for significant divergences in national rules leading to different interpretations of those rules and to legal uncertainty. This allowed institutions to exploit regulatory loopholes, distorting competition and making it burdensome for firms to operate across the single market. The European System of Financial Supervision framework requires each European Supervisory Authority to develop and maintain an enhanced "Single Rulebook" providing comprehensive and, where appropriate, more granular rules at different levels of EU legislation and guidance.

16. On essential elements, this implies more EU rules set out in Level 1, namely regulations and directives. On non-essential elements, this implies more EU rules set out in delegated or implementing acts at Level 2. Further guidance and clarifications can then also be provided in guidelines or Q&As issued by the European Supervisory Authorities at Level 3. In addition, instead of directives that generally allow Member States to decide how they are transposed into national law, more harmonization can be obtained through directly applicable regulations at Level 1 for future sectoral legislation, or for existing legislation that comes up for review. The required level of harmonization could also be set out in regulations or directives and fewer opt-outs allowed.

17. **Figure 1** shows the structure of the European System of Financial Supervision and **Figure 2** shows the positioning of the European Supervisory Authorities in the EU institutional framework.

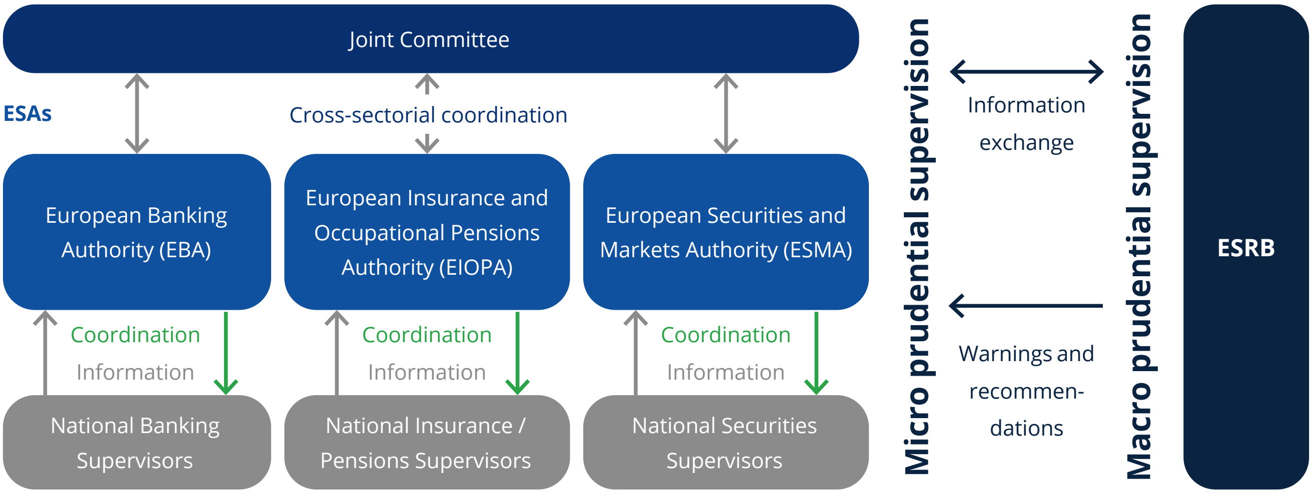
17 See https://www.eba.europa.eu/homepage. The EBA is an independent EU Authority responsible for safeguarding the integrity and robustness of the entire EU banking sector including both eurozone and non-eurozone EU member states. The European Central Bank (ECB) (https://www.ecb.europa.eu/home/html/index.en.html) is the central bank of the EU countries which use the euro, and its responsibilities include supervising euro area banks to make them more robust. Thus, the stated responsibilities of the EBA and ECB overlap which creates a complex relationship between the two. One representative nominated by the Supervisory Board of the ECB sits on the EBA's Board of Supervisors as a non-voting member. Other measures to foster coordination and harmonization between the EBA and ECB includes the establishment, on March 18, 2024, of a Joint Bank Reporting Committee to make data reporting by the banking industry more efficient as well as harmonize and integrate reporting of statistical, supervisory, and resolution data with the aim of developing common definitions and standards – see press release at https://www.bankingsupervision.europa.eu/press/pr/date/2024/html/ssm.pr240318~b1e11a6a60.en.html

18 See https://www.eiopa.europa.eu/index_en

19 See https://www.esma.europa.eu/

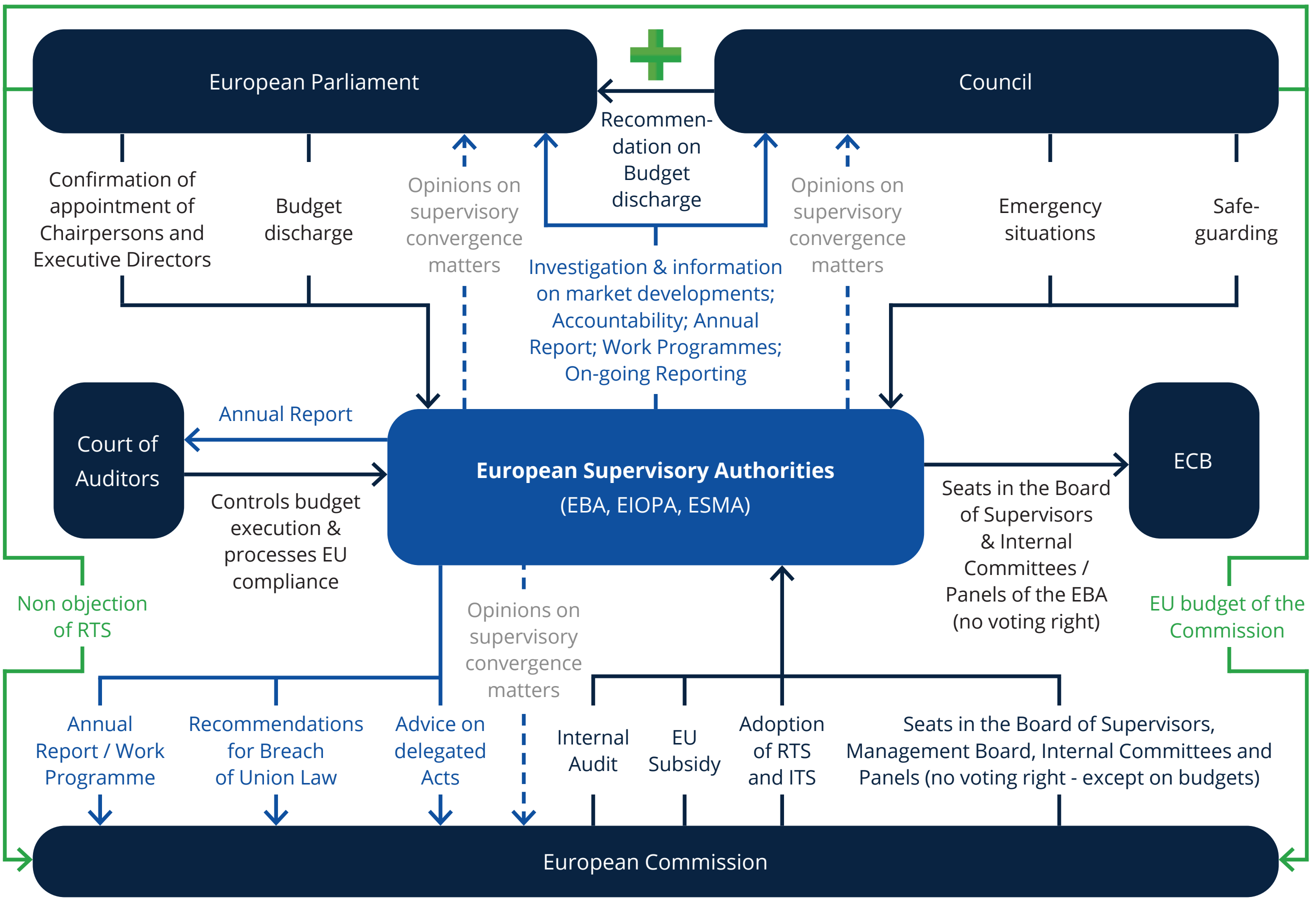
Figure 1. European system of financial supervision

The ESFS



Source: Mazars and European Parliament[20]

Figure 2. The positioning of the European Supervisory Authorities in the EU institutional framework



Source: Mazars and European Parliament[21]

20 Review of the New European System of Financial Supervision Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA and ESMA), Mazars, Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policy, European Parliament, IP/A/ECON/ST/2012-23 October 2013. See https://www.europarl.europa.eu/thinktank/en/document/IPOL-ECON_ET(2013)507446 and https://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/507446/IPOL-ECON_ET(2013)507446_EN.pdf.

21 ibid

18. In September 2020, the Commission published its second Action Plan for Capital Markets Union.[22] In this Action Plan, the Commission committed to: (i) work towards an improved single rulebook by assessing the need for further harmonization of EU rules; and (ii) take stock of what had already been achieved in supervisory convergence. In May 2022, the Commission reported to the European Parliament and the Council on the operation of the European Supervisory Authorities.[23] The report noted whilst activities during the previous decade had focused on building the Single Rulebook for financial services and fostering supervisory convergence, there was still a need for continued and appropriately targeted efforts to promote a genuine Capital Markets Union. The Commission engaged in a broad consultation and respondents to the consultation gave a generally positive assessment of the impact of the European Supervisory Authorities on: (i) financial stability; (ii) the functioning of the internal market; (iii) the quality and consistency of supervision; (iv) the strengthening of international supervisory coordination; (v) consumer and investor protection; (vi) sustainable finance; and (vii) digital finance. The report made the following suggestions:

- Transparency on how rules are applied across the EU could be increased. For example, the European Supervisory Authorities could create a web-based tool that would make it possible for all stakeholders to report cases of supervisory inconsistencies.
- The focus on enforcement could be increased in supervisory convergence tools to foster the consistent application of enforcement measures, including sanctions. A similar goal could be achieved by ensuring that the European Supervisory Authorities collect comprehensive data on enforcement cases across the EU.
- Ad-hoc peer reviews of competent authorities could be used to a greater extent as an ex-post tool in case of events with major supervisory implications. In addition, greater focus on urgent or unforeseen supervisory issues could contribute to more efficient use of peer reviews given that peer reviews require a lot of resources.
- Each of the European Supervisory Authorities has developed its own informal supervisory convergence tools in a different way. This is due to the different regulatory frameworks in which they operate. The Commission agreed with stakeholders that these tools had been proven very effective and should continue to be used. The Authorities could also explore to what extent informal tools developed by each other might be usefully incorporated into their own supervisory convergence toolbox.
- More systematic discussion of supervisory cases among National Competent Authorities could be useful to promote convergent supervisory outcomes in comparable situations. The Commission invited the European Supervisory Authorities to draw up criteria on how to select supervisory cases relevant for such exchanges. The Authorities could enhance the value of these discussions by creating a collection of such cases available for consultation by National Competent Authorities.

19. The CEAOB[24] is the framework organization for co-operation between national audit oversight bodies at EU level. Its main objectives are to foster convergence of practice by European audit regulators and the improvement of audit quality in order to further build

22 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/what-capital-markets-union_en and https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan_en

23 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022DC0228

24 See https://finance.ec.europa.eu/regulation-and-supervision/expert-groups-comitology-and-other-committees/committee-european-auditing-oversight-bodies_en

trust in informative, reliable, and independent audit reports. The EU reform of the audit regulatory framework of 2014 (see paragraph 106 below) led to the creation of the CEAOB with the remit to facilitate supervisory convergence and contribute to the effective and consistent application of the statutory audit legislation throughout the EU. The CEAOB is composed of representatives of the national audit oversight bodies of the EU as well as ESMA. Representatives of the national audit authorities of the European Economic Area and the audit public oversight body of Ukraine[25] also participate, whilst the EBA and the EIOPA are observers. A significant part of the work performed within the CEAOB comes from its five sub-groups: International Equivalence and Adequacy; International Auditing Standards; Enforcement; Inspections; and Market Monitoring. The Inspections sub-group includes a few task forces, most notably a Common Audit Inspection Methodology Project Task Force.

D. Company law harmonization

20. Ongoing efforts towards establishing a modern and efficient company law and corporate governance framework for European undertakings, investors, and employees aim to improve the business environment in the EU. European company law, to the extent it has been harmonized, is codified in "Directive 2017/1132 Relating to Certain Aspects of Company Law". [26,27] Member States continue to operate separate national-level company acts which are amended from time to time to comply with Directive 2017/1132 and other EU directives and regulations. One key objective of company law harmonization is to avoid regulatory arbitrage, whereby companies could choose to incorporate in a Member State with less onerous company laws and then establish themselves or operate in other Member States. It also aims to facilitate the freedom of establishment of companies and to guarantee legal certainty in intra-community operations.

21. Although there is no single codified European company law as such, harmonization of the national rules on company law has created some minimum standards. These cover areas such as the protection of the interests of shareholders and their rights, rules on takeover bids for public limited companies, branch disclosure, mergers and divisions, minimum rules for single-member private limited liability companies, financial reporting and accounting, easier and faster access to information on companies, and certain disclosure requirements for companies. The 2019 Company Law package[28] has streamlined many rules that previously applied under several EU instruments including on:

- Setting up a company and capital and disclosure requirements;
- Company operations involving more than one country;
- Company restructuring (mergers and divisions, transfer of seat);
- Guarantees concerning the financial situation of companies; and
- The cross-border exercise of shareholders' rights.

25 https://finance.ec.europa.eu/regulation-and-supervision/expert-groups-comitology-and-other-committees/committee-european-auditing-oversight-bodies_en#composition

26 Directive (EU) 2017/1132 of the European Parliament and of the Council of June 14, 2017, relating to certain aspects of company law – see https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32017L1132

27 See https://www.europarl.europa.eu/factsheets/en/sheet/35/company-law

28 See https://commission.europa.eu/business-economy-euro/doing-business-eu/company-law-and-corporate-governance_en

22. EU company law also provides for the possibility of some types of European legal entities that can operate throughout the EU and coexist with national ones. These entities include: the European Company; the European Cooperative Society; and European Economic Interest Grouping.

23. In respect of company reporting, the EU has specified various harmonizing requirements in the form of directives and regulations including the following (see Chapter 2 for more details):

- on financial reporting:[29] the 2013 Accounting Directive,[30] the 2002 International Accounting Standards Regulation,[31] and two further directives which address the specific nature of the banking and insurance sectors: the Banking Accounts Directive of 1986,[32] and the Insurance Accounts Directive of 1991.[33]
- on corporate sustainability reporting: the 2014 Non-Financial Reporting Directive[34] (NFRD) until overtaken by the 2022 Corporate Sustainability Reporting Directive (CSRD).[35]
- on auditing of companies' financial statements:[36] Directive 2014/56[37] on statutory audits of annual accounts and consolidated accounts, and Regulation 537/2014[38] on specific requirements regarding statutory audits of public interest entities such as listed companies, banks, and insurance undertakings.

29 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/financial-reporting_en

30 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013L0034

31 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32002R1606

32 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

33 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

34 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0095

35 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464

36 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/auditing-companies-financial-statements_en

37 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0056

38 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0537

2

Accounting, sustainability reporting, and auditing in the acquis communautaire

24. The Treaty of Rome set out conditions to closely coordinate Member States' economic policies and bring about the completion of the single 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 single 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 1**). This section summarizes those parts of the **EU acquis** which relate to accounting, financial reporting, and auditing.

A. Accounting and sustainability reporting: the acquis communautaire as it applies to corporate sector accounting and sustainability reporting

25. As mentioned in paragraph 23, the EU has various pieces of harmonizing requirements on financial and sustainability reporting, primarily:[39]

39 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/financial-reporting_en

Box 1. Why? Examples of the reasons for harmonization[40]

Creditors	Investors, financial analysts, parent-companies, etc.	Preparers
Align safeguards to protect creditors of limited liability companies.	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.	Within multinationals, the effort of accountants to prepare and to consolidate accounts is much simplified if annual accounts from all around the EU are prepared on the same basis.

- **Financial reporting:**[41]
  - the 2013 Accounting Directive[42] which requires all limited liability companies established in the EU to prepare financial statements. The Directive harmonizes requirements about: presentation and content of annual or consolidated financial statements; presentation and content of management reports; the measurement basis companies use to prepare their financial statements; audit of financial statements; publication of financial statements; and the responsibility of management with regards to all of the above. The Directive also defines micro, small, medium, and large companies based on turnover, total assets, and number of employees and thereafter, with the aim of reducing the burden of financial reporting for small companies, allows simplified reporting regimes for these classes of companies.
  - the 2002 International Accounting Standards Regulation[43] which requires listed companies (those whose securities are traded on an EU regulated market) to prepare their consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Commission (having regard to the advice the Accounting Regulatory Committee[44] which was set up specifically for this purpose as well as the EFRAG).[45]

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

41 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/financial-reporting_en

42 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013L0034

43 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32002R1606

44 See https://finance.ec.europa.eu/regulation-and-supervision/expert-groups-comitology-and-other-committees/accounting-regulatory-committee_en

45 See https://www.efrag.org

  - two further directives which address the specific nature of the banking and insurance sectors: the Banking Accounts Directive of 1986,[46] and the Insurance Accounts Directive of 1991.[47]

- **Corporate sustainability reporting including non-financial information:**
  - the 2022 CSRD[48] which requires a broad set of large companies, as well as listed SMEs, to report on sustainability in accordance with European Sustainability Reporting Standards (ESRS) developed by the EFRAG and published in December 2023 under the form of a delegated regulation.[49] The first companies that have to apply the new ESRS do so from the 2024 financial year, for reports published in 2025.
  - The 2014 NFRD,[50] which remained in force until companies have to apply the new rules of the CSRD commencing 2024 financial year. The NFRD required public interest entities including listed companies, banks, and insurance undertakings with more than 500 employees, to publish information related to environmental matters, social matters, treatment of employees, respect for human rights, anti-corruption and bribery, and diversity on company boards (in terms of age, gender, educational, and professional background).
  - Article 19 of the Accounting Directive requires that a company's management report includes both financial and, where appropriate, non-financial key performance indicators to the extent necessary for an understanding of the undertaking's development, performance or position, including information relating to environmental and employee matters.

The EU default regime for annual and consolidated financial statements

The Accounting Directive applies to limited liability companies

26. The Accounting Directive is the backbone of the EU acquis on financial reporting for limited liability companies established within the EU. It is based on the Treaty on the Functioning of the European Union (TFEU) provision allowing coordination of legislation to make the safeguards required by Member States of companies, for the protection of the interests of Members and others, equivalent throughout the Union (Article 50, 2(g) TFEU). The Accounting Directive is part of European company law (in other parts of the world, for instance in the United States of America (US), financial reporting standards are enforced through securities regulations). The EU aim is to protect a wide group of users including shareholders, lenders and other creditors, employees, etc. i.e., a broader group than just investors in capital markets. This is emphasized by Recitals 3 and 4 preceding the text of the Directive: “Annual financial statements pursue various objectives and do

46 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

47 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

48 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464

49 See https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32023R2772

50 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0095

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”.

27. 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 Republic of Ireland: public companies limited by shares or by guarantee, private companies limited by shares or by guarantee).

28. Against the background of the Small Business Act (2008), a proposal was made to leave the very smallest 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 stated that the requirement to prepare and publish financial statements was the price to pay for benefiting from limited liability. Any difference should only be made at the level of requirements, which should not be the same for small and large companies.

29. 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. Also, some Member States introduced partnerships that specifically benefit from limited liability. 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 of the Directive provides a full list of unlimited legal forms of undertakings covered by the Directive detailed by each EU Member State (e.g., in the Republic of Ireland: 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.”

30. 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 from requiring undertakings that 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 specifies that 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. The Directive 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.

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

The Accounting Directive's "building blocks" approach

32. The Accounting Directive specifies essential financial reporting requirements applicable to all undertakings including micro entities. More detailed rules and additional disclosures are imposed on larger undertakings according to their size. This permits the legislator to clearly define the size of the undertakings to which it wants a new and additional requirement to apply.

33. The Directive defines four levels of undertakings: micro, small, medium-sized, and large. Public interest entities are not subject to simplifications and exemptions, unless expressly provided by the Directive. A public interest entity shall be treated as a large undertaking regardless of its net turnover, balance sheet total, or average number of employees during the financial year. Additionally, the text defines three levels of groups of undertakings. The thresholds used by the Directive to define each level of undertaking are for both 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 (**Table 1**) for two successive accounting periods. The values of the monetary thresholds are regularly increased to take into account monetary and economic developments.

34. 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.

35. 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.

51 In order to adjust for the effects of inflation, at least every five years the Commission shall 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). The thresholds, last updated on October 17, 2023, can be found here https://ec.europa.eu/transparency/documents-register/detail?ref=C(2023)7020&lang=en and European Commission guidance notes can be found here https://finance.ec.europa.eu/publications/guidance-implementation-and-interpretation-directive-201334eu-accounting-rules_en. Member States have the option to allow companies to apply the adjusted size criteria for the financial year beginning on or after January 1, 2023.

Table 1. Thresholds defining categories of undertakings and groups at October 17, 2023 (satisfy 2 of 3 criteria)

Undertaking / group	Balance sheet total (000 €)	Net turnover (000 €)	Average number of employees
Micro entity	≤ 450	≤ 900	≤ 10
Small undertaking	≤ 5.000	≤ 10.000	≤ 50
Optional increase for Member States	≤ 7.500	≤ 15.000	≤ 50
Medium-sized undertakings	≤ 25.000	≤ 50.000	≤ 250
Large undertaking	> 25.000	> 50.000	> 250
Small group	≤ 7.000	≤ 15.000	≤ 50
Medium-sized group	≤ 25.000	≤ 50.000	≤ 250
Large group	> 25.000	> 50.000	> 250

- The perception by some Member States that higher thresholds for defining SMEs are a key way of limiting the administrative burdens for companies.

36. Therefore, the Accounting Directive (2013) goes for 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 half, the default thresholds for small undertakings' turnover and balance sheet total.

37. 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

38. 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, a departure from these provisions may be warranted to provide a true and fair view. This "true and fair view override" has been extensively discussed and remains a heavily debated topic in the context of international accounting standard setting.[52]

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

39. The Accounting Directive contains minimum recognition and measurement principles (referred to as "valuation rules").[53] Article 6.1 defines general accounting principles, which are summarized in **Box 2** below:

Box 2. Accounting valuation rules - minimum recognition and measurement principles

- 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;[54]
- 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 the 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.

40. The Conceptual Framework for Financial Reporting of the 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" (section 1.17). 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 Accounting Directive 2013 requires accrual accounting for all reporting entities, save for a limited option for Member States to allow micro entities to apply some form of cash accounting (Article 36 a).

41. Historical cost (purchase price or production cost) remains the default measurement regime in the Accounting Directive 2013. However, by way of derogation, Article 7 permits Member States to provide for an alternative measurement basis of fixed assets at revalued

53 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.

54 Exceptions to this principle are however possible; See Accounting Directive Article 6.2

amounts. Furthermore, with the adoption of European Commission Regulation No 1606/2002 and the subsequent endorsement of individual IFRS Accounting Standards,[55] new recognition and measurement principles became part of the EU acquis, in particular measurement at fair value. 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.

42. Moreover, some recognition and measurement options allow Member States to closely align financial reporting requirements with tax accounting.[56] 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."[57] 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 purposes. The Directive also authorizes applications of this principle, for instance related to provisions[58] that would not be fully in line with IFRS Accounting Standards. Despite the risk of misinterpretation, prudence should continue to play an important role.[59] "Substance over form" raises similar problems, which generated long discussions in the preparation of the Directive. Therefore Article 6.3 allows Member States to provide for exceptions to this principle.

43. 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, see 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.

55 To be adopted for application in the EU a standard must meet the conditions set out in Article 3 of European Commission Regulation 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.

56 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

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

58 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."

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

Presentation of annual financial statements and disclosures

44. 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."

45. The Accounting Directive 2013 sets out standardized formats for the layout of the balance sheet and the profit and loss accounts. 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.

46. 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, as shown in **Box 3** below.

Box 3. Building-block approach to presentation of financial statements

- Micro-entities are subject to a set of stand-alone exemptions and 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 nevertheless a reduced set of information in the notes (Article 17) and not to draw up consolidated accounts (Article 23).
- Large companies and public interest entities are not entitled to benefit from exemptions. They are submitted to the largest number of disclosures (Article 18).

47. 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).

48. 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 / corporate sustainability reporting

49. A reporting entity's management report and consolidated management report are not components of its 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.

50. The specific disclosure requirements for non-financial information in a company's annual report are in the process of changing very significantly. There are three main sources of these disclosure requirements for non-financial information: the original Accounting Directive 2013; the 2014 NFRD[60] that amends the Accounting Directive; and the 2022 CSRD[61] that further amends the Accounting Directive. This section will present the requirements of each.

51. Article 19 of the Accounting Directive requires that a company's management report includes both financial and, where appropriate, non-financial key performance indicators to the extent necessary for an understanding of the undertaking's development, performance, or position, 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 in respect of consolidated management reports. 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).

52. 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).

53. The 2014 NFRD, which was issued after and amends the Accounting Directive, requires large public interest entities (mainly listed companies and financial institutions as well as companies designated as public interest entities by national authorities) with more than 500 employees to disclose certain non-financial information. Disclosures relate to policies, risks, and results as regards environmental matters, social matters, treatment of employees, respect for human rights, anti-corruption and bribery issues, and diversity on company boards. The disclosure requirements of the NFRD go well beyond what is required by Articles 19 and 29 of the Accounting Directive 2013. The NFRD will be phased out, however, as the CSRD is phased in (as discussed below).

54. The reporting requirements of the CSRD are significantly more detailed and onerous than those of the NFRD. In its communication of December 2019, the European Commission made a commitment to review the provisions of the NFRD to make it

60 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0095

61 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464

consistent with the European Green Deal.[62] The Green Deal is the EU's growth strategy which aims to transform the EU into a modern, resource-efficient, and competitive economy with no net emissions of greenhouse gases by 2050. The CSRD is effectively the result of the Commission's review of the NFRD in light of the Green Deal and as such ensures that sustainability reporting and financial reporting become of equal importance.

55. The 2022 CSRD requires a broad set of large companies, as well as listed SMEs, to report sustainability-related information in accordance with ESRS developed by the EFRAG. The first set of 12 mandatory ESRSs, comprising two general and ten topical ESRSs, were approved by the European Commission in July 2023 annexed to Delegated Regulation 20223/2772.[63] In December 2024, the EFRAG released the Voluntary Sustainability Reporting Standard for non-listed SMEs (VSME).[64] The EFRAG is expected to develop and publish additional sets of ESRSs in due course to include sector-specific standards, standards for SMEs, and a standard on non-EU parent companies. **Table 2** below presents the sustainability matters covered in the extant set of ESRSs.

Table 2. The 12 European Sustainability Reporting Standards endorsed July 2023

ESRS	Objective of ESRS / Focus of topical ESRSs
ESRS 1 General requirements	Provides an understanding of the architecture of ESRS, the drafting conventions and fundamental concepts used, and the general requirements for preparing and presenting sustainability information.
ESRS 2 General disclosures	Sets out the disclosure requirements that apply to all undertakings regardless of their sector of activity (i.e., sector agnostic) and apply across sustainability topics (i.e., cross-cutting). Covers the reporting areas defined in ESRS 1, Section 1.2-cross-cutting standards and reporting areas.
ESRS E1 Climate change	■ Climate change adaptation and mitigation ■ Energy
ESRS E2 Pollution	■ Pollution of air, water, soil, living organisms and food resources ■ Substances of concern and very high concern ■ Microplastics
ESRS E3 Water & marine resources	■ Water ■ Marine resources
ESRS E4 Biodiversity and ecosystems	■ Direct impact drivers of biodiversity loss ■ Impacts on the state of species ■ Impact of the extent and condition of ecosystems ■ Impacts and dependencies on eco-systems services

62 See https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en

63 See https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32023R2772

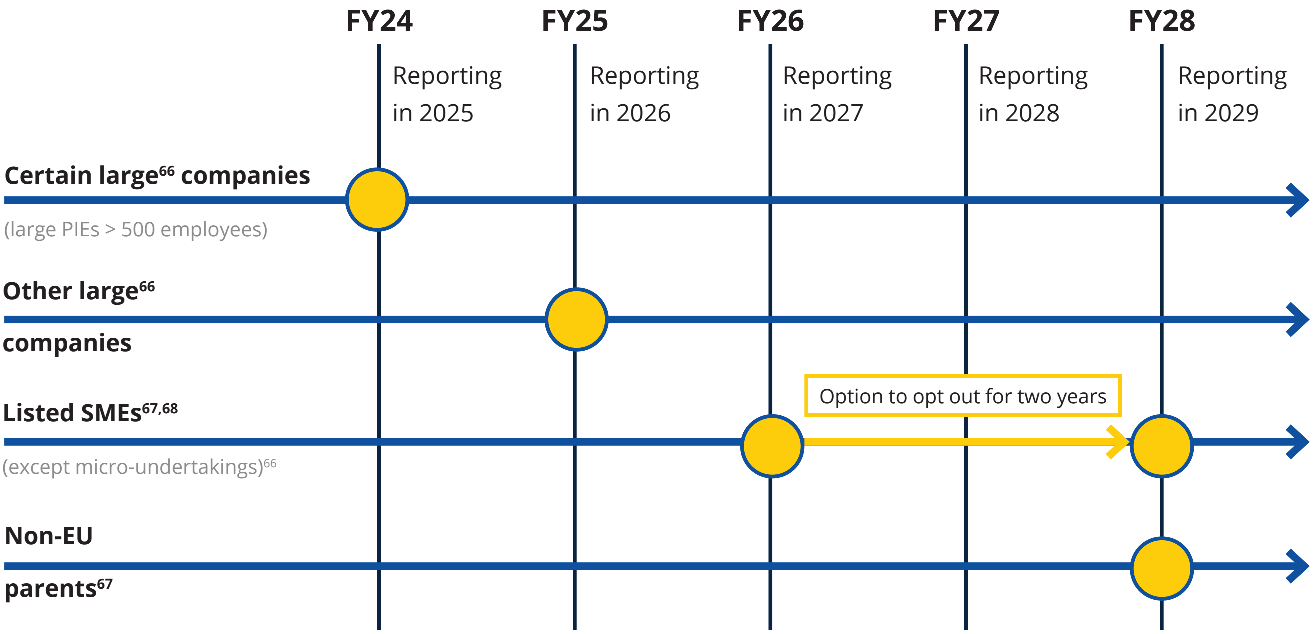
64 See https://www.efrag.org/en/news-and-calendar/news/efrag-releases-the-voluntary-sustainability-reporting-standard-for-nonlisted-smes-vsme

ESRS	Objective of ESRS / Focus of topical ESRSs
ESRS E5 Circular economy	■ Resources inflows, including resource use ■ Resource outflows related to products and services ■ Waste
ESRS S1 Own workforce	■ Working conditions ■ Equal treatment and opportunities for all ■ Other work-related rights
ESRS S2 Workers in the value chain	■ Working conditions ■ Equal treatment and opportunities for all ■ Other work-related rights
ESRS S3 Affected communities	■ Communities' economic, social, and cultural rights ■ Communities' civil and political rights ■ Rights of indigenous peoples
ESRS S4 Consumers and end-users	■ Information-related impacts for consumers and/or end-users ■ Personal safety of consumers and/or end-users ■ Social inclusion of consumers and/or end-users
ESRS G1 Business conduct	■ Corporate culture ■ Protection of whistle-blowers ■ Animal welfare ■ Political engagement and lobbying activities ■ Management of relationships with suppliers including payment practices ■ Corruption and bribery

56. ESRSs apply for years beginning on or after January 1, 2024, for reporting in 2025. The phased introduction starts with public interest entities and companies with listed securities on EU-regulated markets which are large and have more than 500 employees. Public interest entities are defined in Article 2 paragraph (1) of the Accounting Directive as: (a) entities governed by the law of a Member State and whose transferable securities are admitted to trading on a regulated market of any Member State; (b) credit institutions; (c) insurance undertakings; and (d) entities designated as such by Member States, such as undertakings that are of significant public relevance because of the nature of their business, their size, or the number of their employees.[65] Large companies, with reference to paragraph 33 above, have a total balance sheet of more than €25 million and net turnover of more than €50 million. **Figure 3** below presents the timetable for the adoption of ESRSs. In the interim, all entities will continue to comply with the narrower requirements of the NFRD and Accounting Directive 2013 to the extent that they are required to do so.

65 A June 2022 study of how 30 European countries define public interest entities shows that 11 countries follow the categories as narrowly specified in the EU Directive whereas 19 countries adopted an extended national definition – see https://accountancyeurope.eu/wp-content/uploads/2022/12/PIE-definition-2022_Accountancy_EU.pdf

Figure 3. ESRS adoption timeline



Source: Get Ready for European Sustainability Reporting Standards, November 2023, KPMG.[69]

57. The ESRSs introduce two particularly noteworthy conceptual differences with their counterpart financial reporting standards: the reporting boundary and double materiality. The reporting boundary for sustainability reporting is based on the financial reporting boundary but expanded to cover material impacts, risks, and opportunities related to the upstream and downstream value chain. This will lead to different reporting boundaries for the purposes of an undertaking's financial reporting and sustainability reporting as presented in **Figure 4** below.

58. Content disclosed in sustainability reporting comprises: mandatory information for all companies as set out in ESRS 2 (General disclosures); and information that a company considers material. In order to determine what information is material for the purposes of sustainability reporting, ESRSs require companies to perform **double materiality** assessments from both an impact perspective and a financial perspective.

- **Impact materiality** will require disclosure of sustainability-related matters that relate to a company's material actual or potential, positive or negative, impacts on people or the environment over the short, medium, or long terms. ESRS 1 (General requirements) specify the steps that a company needs to consider to assess impact materiality.
- **Financial materiality** will require disclosure of sustainability-related matters that (may) trigger material financial effects on a company's development e.g., cash flows, financial position, or financial performance in the short, medium, or long terms.

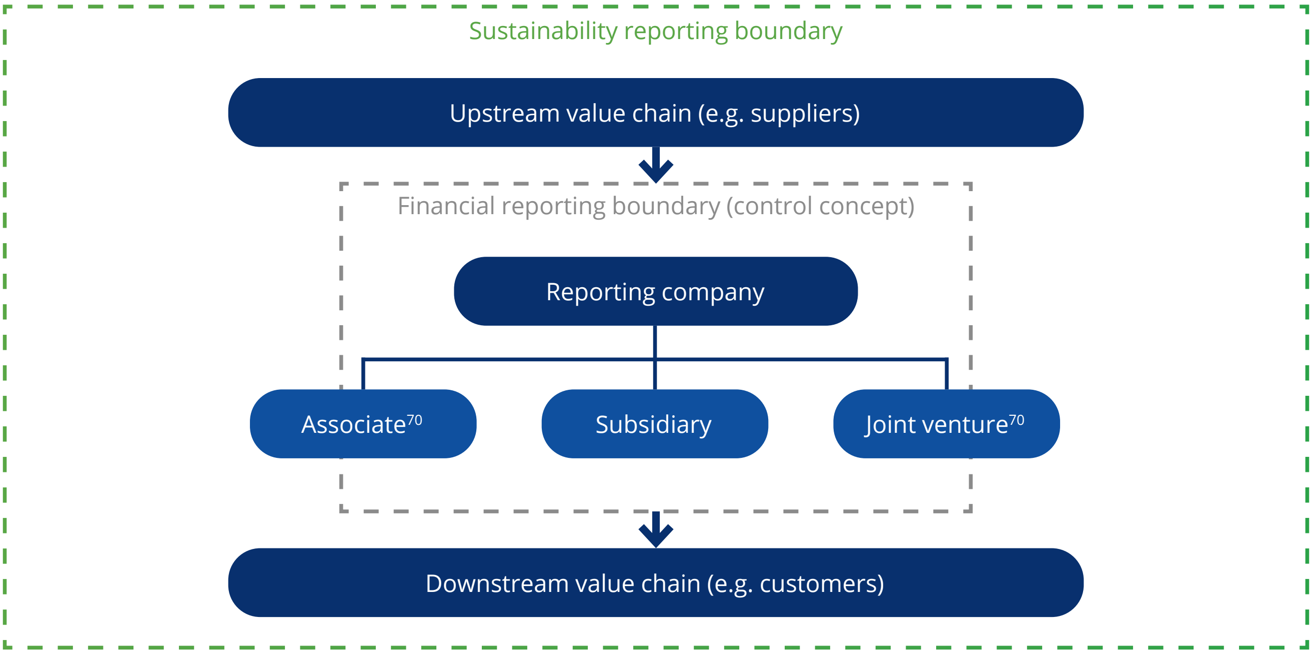
66 Large companies and micro-undertakings are defined as for financial reporting requirements as discussed and presented above in paragraph 33.

67 Separate standards will be developed for SMEs and non-EU parent companies

68 Small and non-complex institutions and captive insurers are treated like listed SMEs (the option to opt out until 2028 does not apply unless they also meet the definition of an SME).

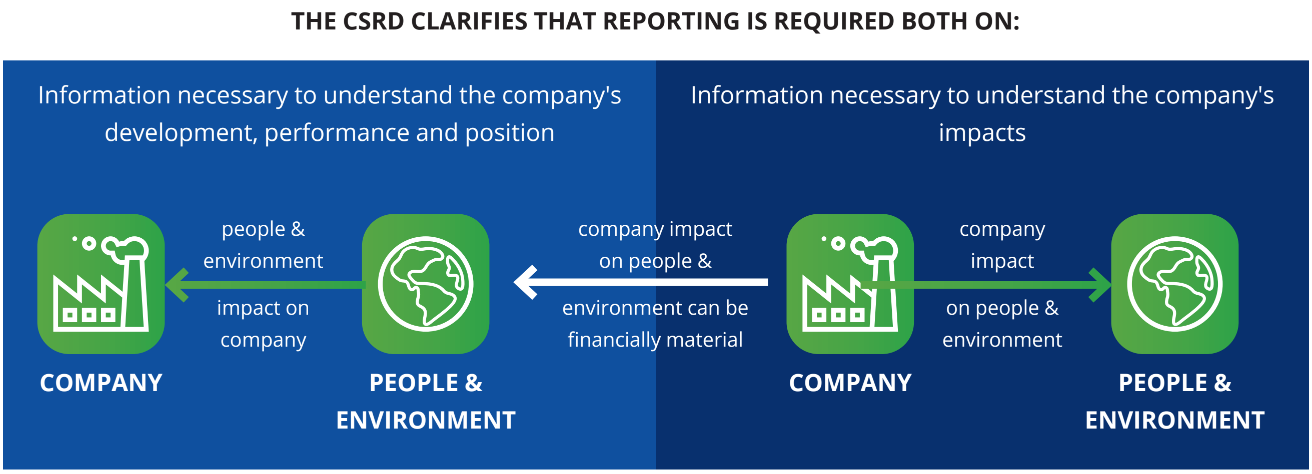
69 See https://kpmg.com/xx/en/home/insights/2022/05/european-sustainability-reporting-standards-eu-esrs.html

Figure 4. Boundaries for sustainability and financial reporting



Source: Get Ready for European Sustainability Reporting Standards, November 2023, KPMG.[71]

Figure 5. Double materiality for the purposes of corporate sustainability reporting



Source: European Commission

70 Associates and joint ventures may form part of the upstream or downstream value chain.

71 See https://kpmg.com/xx/en/home/insights/2022/05/european-sustainability-reporting-standards-eu-esrs.html

59. The European Commission's and the EFRAG's approach to the development of ESRSs has been to work towards convergence with international sustainability reporting with a view, consistent with its approach to harmonization on IFRS Accounting Standards (see paragraph 81 below and following), to reducing the burden of compliance for cross-country reporting especially for listed companies. Thus, in July 2021, the EFRAG and the Global Reporting Initiative[72] signed a Statement of Cooperation[73] to co-construct ESRSs.[74] The European Commission and the EFRAG are also members of the IFRS's Jurisdictional Working Group,[75] whose purpose is to establish dialogue for enhanced compatibility between the work of the IFRS Foundation's International Sustainability Standards Board[76] in developing Sustainability Disclosure Standards and the other ongoing jurisdictional initiatives on sustainability disclosures including that of the Commission and the EFRAG in respect of ESRSs. The EU is considerably ahead of other jurisdictions in terms of sustainability reporting in that the European Commission has already issued a suite of 12 sustainability reporting standards and, as discussed above in paragraph 56, requires entities to comply with those standards. By comparison, as at the time of writing this guide, the IFRS Foundation's International Sustainability Standards Board had only issued two sustainability disclosure standards,[77] of significantly less scope than ESRSs and though they both came into effect on January 1, 2024, they have not been adopted by any jurisdiction. The objective of IFRS S1 and S2 is to require an entity to disclose information about its sustainability and climate related risks and opportunities that are useful to users of general-purpose financial reports in making decisions relating to providing resources to the entity.

60. The Competitiveness Compass,[78] presented in January 2025, is the Commission's new roadmap to restore Europe's dynamism and boost its economic growth. As promised in their presentation of the Compass, the Commission adopted a new package of detailed proposals on 26 February 2025, to simplify rules including on sustainable finance reporting and EU Taxonomy for consideration by the European Parliament and Council.[79] If adopted, these will have a significant impact on the corporate sustainability reporting framework particularly in respect of: the number of undertakings subject to mandatory sustainability reporting requirements; the application of voluntary SME standards for those undertakings not subject to mandatory reporting requirements; the removal of sector-specific reporting standards; the introduction of an "opt-in" regime to eliminate entirely the cost of compliance with the taxonomy reporting rules for large undertakings which do not claim that their activities are associated with economic activities that qualify as environmentally sustainable under the Taxonomy Regulation; simplification and

72 The Global Reporting Initiative is an independent international organization that was founded in response to public outcry over the major environmental damage of the 1989 Exxon Valdez oil spill. It initially aimed to create the first accountability mechanism to ensure companies adhere to responsible environmental conduct principles, and has since been broadened to include social, economic, and governance issues – see https://globalreporting.org/about-gri/mission-history/. It has issued around 40 sustainability reporting standards in three groups known as universal standards, sector standards, and topic standards – see https://globalreporting.org/how-to-use-the-gri-standards/resource-center/.

73 See https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520GRI%2520COOPERATION%2520PR.pdf.

74 See concordance table between the Global Reporting Initiative Standards and ESRS at https://www.globalreporting.org/media/z2vmxbks/gri-standards-and-esrs-draft-interoperability-index_20231130-final.pdf

75 See https://www.ifrs.org/groups/jurisdictional-working-group/#members

76 See https://www.ifrs.org/groups/international-sustainability-standards-board/

77 See https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/

78 See press release announcing the EU Competitive Compass https://ec.europa.eu/commission/presscorner/detail/en/ip_25_339

79 See EC press release at https://ec.europa.eu/commission/presscorner/detail/en/ip_25_614

streamlining revisions to the extant ESRSs; and the postponement by two years of some of the reporting requirements. Further information on the Compass roadmap as well as the new package of proposals is presented in paragraphs 154 below. **Once changes in the sustainability reporting requirements are officially adopted by the European Parliament and Council, this guide will be updated accordingly.**

61. Entities whose transferable securities are admitted to trading on a regulated market are required by the CSRD to include a **corporate governance statement i**n 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 and sustainability reporting process.

62. Finally, Chapter 10 of the Accounting Directive 2013 requires "Member States [to] 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 serves to enhance the transparency of payments made to governments of resource-rich countries.

Publication, responsibility, and statutory audit

63. 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 Registration Office in the Republic of Ireland). 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 present 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.

64. In 2013, the Transparency Directive (Directive 2004/109/EC),[80] which sets rules on the harmonization of transparency requirements of issuers, was amended to include, amongst others, a requirement for issuers whose securities are admitted to trading on EU regulated markets to prepare their annual financial reports in a single electronic reporting format. ESMA developed regulatory technical standards to specify this electronic reporting format,[81] including detailed provisions and the underlying policy choices.[82] ESMA amends the regulatory technical standards to incorporate updates on the single electronic reporting format taxonomy and developments in the market as necessary. Reflecting the political agreement on the CSRD, as from January 1, 2024, undertakings will be required

80 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02004L0109-20210318

81 See https://www.esma.europa.eu/issuer-disclosure/electronic-reporting

82 See https://www.esma.europa.eu/sites/default/files/library/esma32-60-850_final_report_draft_rts_amending_rts_on_esef.pdf

to follow the single electronic reporting format by preparing their management reports in the XHTML format and marking-up sustainability information, including the disclosures required by Article 8 of Regulation 2020/852 (the Taxonomy Regulation) using the Inline XBRL technology. The EFRAG has the mandate to develop a digital XBRL taxonomy for the ESRS to tag sustainable statements in a structured, machine-readable data format, which will enable users of ESRS disclosures to analyze the information,[83] avoiding manual and error-prone transformation from a PDF or printed document.

65. 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 (Accounting Directive 2013, 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).

66. 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.

67. The scope of statutory audit also derives from the Accounting Directive which requires that, except for the exemptions available for small companies, annual accounts 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 Directive 2006/43/EC that is further commented on in section 3.D of this guide.

68. The CSRD requires limited assurance across all ESRS topics from the date of an entity's initial reporting, with the ambition to move to reasonable assurance at a future date. A more detailed discussion of the assurance requirements on a company's sustainability reporting is presented below in paragraph 137.

The Bank Accounts Directive

69. Recognizing the special nature of the activities of banks and other financial institutions (hereafter referred to as "banks") and of insurance undertakings, the financial reporting requirements of banks are specified in the Directive on the Annual Accounts of Banks and other Financial Institutions (86/635/EEC) (Bank Accounts Directive),[84] and those of insurance undertakings by the Insurance Undertakings Directive (91/674/EEC) (Insurance Accounts Directive).[85]

83 A draft list of ESRS data points published by EFRAG features in total over 1,000 disclosures across 12 categories.

84 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

85 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

70. The Bank Accounts Directive applies to annual and consolidated accounts of banks established in the EU regardless of their legal form (but not to branches, see paragraph 79). The Bank Accounts Directive covers the same areas as the Accounting Directive and most general provisions are to be read across directly. Apart from applying these read-across provisions to banks, the Bank Accounts 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 Accounting Directive.

71. The provisions set out in the Bank Accounts 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 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 banking risks; if hidden reserves are not permitted, the Bank Accounts 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 Bank Accounts Directive also includes a number of other options regarding foreign exchange translation.

72. 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 Bank Accounts 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 Accounting Standards changed this drastically for publicly-traded banks, which prepare consolidated accounts (see paragraph 85).

73. The EBA issued a financial reporting framework for banks – FINREP (FINancial REPorting Standards),[86] based on IFRS Accounting Standards. This framework specifies the financial reporting information required and applies to all credit institutions and investment firms. FINREP 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. FINREP has been frequently revised to increase harmonization as well as to reflect changes in IFRS Accounting Standards endorsed by the European Commission as well as the Capital Requirements Directive.

74. The EBA also published a regulatory reporting framework – COREP (COmmon REporting Standards).[87] These guidelines are to be used by banks when preparing prudential reports in accordance with the EU Capital Requirements Directive IV.

The Insurance Accounts Directive

75. The Insurance Accounts Directive applies to undertakings engaged in life insurance, non-life insurance, or reinsurance business.

76. Financial statements of insurance undertakings comprise a balance sheet, a profit and loss account, and notes. The Insurance Accounts Directive requires that the accounts be prepared in accordance with its detailed provisions and, by reference to the Accounting Directive, that individual and consolidated accounts give a true and fair view of the financial position and performance of insurance undertakings. While the Insurance Accounts Directive broadly harmonizes accounting for insurance undertakings in the EU, the existence of numerous options restricts comparability. The requirement to apply endorsed IFRS Accounting Standards changed this drastically for publicly-traded insurance undertakings which prepare consolidated accounts (see paragraph 85).

77. Differences in requirements to those imposed on companies in general (through the Accounting Directive) 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 Directive are abandoned in favor of a single concept of investments which includes all lands and buildings. The Insurance Accounts 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.
- **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 Insurance Accounts 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.

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

87 See http://corep.support/what-is-corep.html

- Technical provisions – The Insurance Accounts Directive requires insurance undertakings to draw sector specific provisions, including technical provision for unearned premiums, life assurance provision, claims outstanding, and equalization provisions.[88]

78. The EIOPA was established to supervise the financial sector in the EU. It works to improve the links between annual/consolidated accounts and supervisory reporting by insurance undertakings. The EU prudential framework requires every insurance undertaking to submit to the supervisory authorities the information which is necessary for the purposes of supervision. 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.

Other relevant Company Law Directives and "soft law" Instruments

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

- Directive 2004/109/EC[89] (the Transparency Directive), which sets rules on harmonization of transparency requirements of issuers, was amended in 2013 to include, amongst others, a requirement for issuers whose securities are admitted to trading on EU regulated markets to prepare their annual financial reports in a single electronic reporting format. This is discussed above in paragraph 64.
- Directive 2017/1132/EU relating to certain aspects of company law requires Member States to coordinate with each other with a view to making equivalent safeguard measures for the protection of the interests of members and others in respect of the formation of public limited liability companies and the maintenance and alteration of their capital.[90] 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 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 maintenance, increase, or reduction of capital.
- Directive 2017/1132/EU relating to certain aspects of company law sets down general rules on profit distribution. Except for cases of reductions of subscribed capital, no distribution to shareholders may be made when on the closing date of the last financial year the net assets as set out in the company's annual accounts are or, following such a distribution, would become, lower than the amount of the subscribed capital plus those

88 Provision to compensate the frequent fluctuation in claims that characterizes natural events
89 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02004L0109-20210318
90 See https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32017L1132

reserves which may not be distributed under the law or the statutes of the company. The laws of a Member State may provide for derogation from the preceding condition in the case of investment companies with fixed capital. Additionally, the amount of a distribution to shareholders may not exceed the amount of the profits at the end of the last financial year plus any profits brought forward and sums drawn from reserves available for this purpose, less any losses brought forward and sums placed to reserve in accordance with the law or the statutes.

- Directive 2017/1132/EU relating to certain aspects of company law also lays down measures concerning mergers of public limited liability companies and the division of public limited liability companies.
- Directive 2017/1132/EU relating to certain aspects of company law also 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 these provisions were adopted. Directive 89/117/EEC on Accounting Documents of Branches of Foreign Credit and Financial Institutions[91] extends the scope of Directive 2017/1132/EU to include branches of credit institutions.

B. Financial reporting for issuers on EU regulated financial markets

Developing integrated and liquid capital and financial services markets

80. The European Commission acknowledged in 1995,[92] that EU-specific financial reporting requirements do not provide answers to all the problems facing the preparers and users of accounts and accounting standard setters. In particular, large European companies seeking capital on the international capital markets were usually obliged to present a second set of financial statements prepared in accordance with a second set of financial reporting standards specifically for that purpose, and most often in accordance with IFRS Accounting Standards. This was burdensome and costly and constituted a clear competitive disadvantage.

81. Accordingly, in 2000, the European Commission 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 Commission indicated that the adoption of IFRS Accounting Standards, previously known as International Accounting Standards, was the way forward.[93]

91 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31989L0117

92 European Commission Communication "Accounting Harmonisation: A new strategy vis-à-vis international harmonisation" doc COM (1995), November 14, 1995.

93 European Commission Communication "The EU's Financial Reporting Strategy: The Way Forward" doc. COM (2000)359 of June 13, 2000.

82. 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 Commission contemplated the establishment of an endorsement mechanism with a two-tier structure consisting of a technical level and a political level to confirm the standards to be applied (See **Figure 6**).
- The need for proper enforcement: The Commission noted that high quality accounting standards do not automatically guarantee transparent financial reporting per se; rigorous and disciplined application is vital to the credibility of accounts. To achieve this, the Commission stressed the need for high-quality statutory audit as well as strengthened co-ordination among European securities regulators in order to establish equivalent, high-level enforcement of financial reporting throughout the EU.

Application of International Accounting Standards (IFRS)

83. Regulation (EC)1606/2002 of the European Parliament and of the Council on the application of International Accounting Standards (IFRS)[94] was issued on July 19, 2002. It requires publicly-traded companies to prepare their consolidated accounts in accordance with International Accounting Standards (IFRS) endorsed by the EU. Within this paper, "publicly-traded companies" are those companies with securities admitted to trading on a regulated market in the EU. It is therefore important to understand what a regulated market entails to assess the actual scope of Regulation 1606/2002 (See **Box 4**).

Box 4. EU Regulated Markets

A regulated market is defined in Article 4(21) of Directive 2014/65/EU May 15, 2014 on Markets in Financial Instruments[95] as "a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorized and functions regularly and in accordance with Title III of this Directive" (where Title III sets out the essential characteristics and rules governing regulated markets).

In accordance with Article 56 of the Directive, each Member State draws up a list of the regulated markets for which it is the home Member State and forwards that list, as well as any changes to that list, to other Member States and ESMA. ESMA is then required, also by Article 56, to publish and keep up-to-date a list of all regulated markets on its website.

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

95 The text of Directive 2014/65/EU on Markets in Financial Instruments may be found at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065

Application of IFRS Accounting Standards in Annual Accounts

84. In accordance with the principle of proportionality, Regulation 1606/2002 gives Member States the option to permit or require the following entities to prepare the specified financial statements in accordance with EU-endorsed IFRS Accounting Standards: (i) publicly traded companies in respect of their annual financial statements, and (ii) other companies in respect of their consolidated accounts and/or their annual accounts. As of the date of this publication, only 11 Member States have exercised the option to require all financial and non-financial listed companies to use IFRS Accounting Standards (Cyprus, Czech Republic, Estonia, Greece, Croatia, Hungary, Italy, Latvia, Malta, Portugal, and Slovakia). Additionally, seven Member States have exercised the option to permit all financial and non-financial listed companies to use IFRS Accounting Standards. The Commission regularly updates a table on the use by Member States of options provided in Regulation 1606/2002.[96]

85. Member States may extend this permission or this requirement to other (i.e., non-listed) companies as regards the preparation of their consolidated accounts and/or their [individual entity level] annual accounts. All Member States have exercised the option to permit or require other (i.e., non-listed) companies to use IFRS Accounting Standards for their consolidated financial statements. By contrast, quite a few Member States have not exercised the option to either permit or require other (i.e., non-listed) companies to use IFRS Accounting Standards in their annual accounts. This is largely explained by the fact that IFRS Accounting Standards 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 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.”

Endorsement of IFRS Accounting Standards for use in the EU

86. The IASB is the body which issues IFRS Accounting Standards.[97] However, they are not automatically adopted by the EU as they are issued by the IASB. Instead, each Standard must first be endorsed by the European Commission before it can enter into force. Article 3 of Regulation 1606/2002 sets three conditions that individual IFRS Accounting Standards 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;

96 At the time of publication the most recent update was as at December 31, 2023 and can be found here: https://finance.ec.europa.eu/document/download/1c546870-ee26-4c53-8b12-796bd0b96793_en?filename=311222-ias-regulation-use-of-options-overview_en.pdf

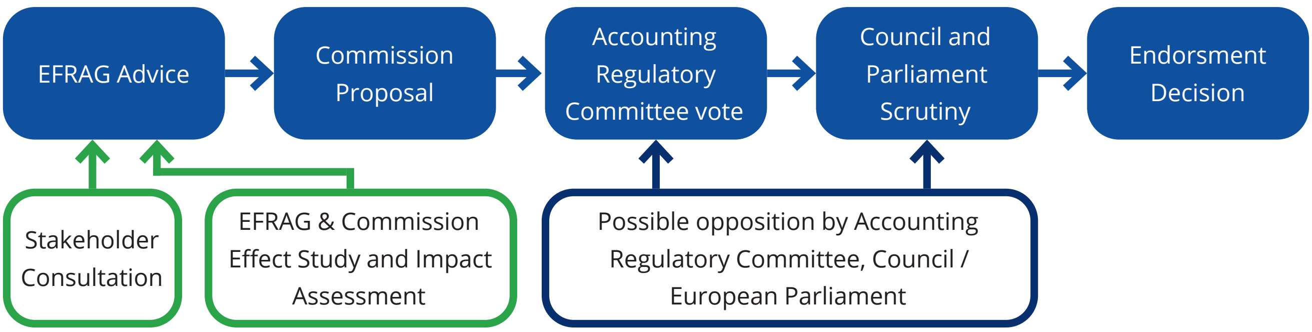
97 See http://www.iasb.org/Home.htm.

- 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).

87. EFRAG frequently updates and publishes the IFRS Endorsement Status Report which contains a list of all IFRS Accounting Standards, amendments, and Interpretations endorsed in the EU and those pending endorsement.[98] The EU endorsement process requires time and as such there is inevitably a risk that some IFRS Accounting Standards and IFRS Interpretations become applicable in the EU at a later date than the effectiveness dates defined by the IASB and the IFRS Interpretations Committee. All IFRS Accounting Standards and Interpretations endorsed by the EU are annexed to Commission Regulation 1126/2008,[99] which is amended with every endorsement and is directly binding without the need for national implementation.

88. The endorsement process established by the Commission in accordance with Regulation 1606/2002 involves a number of stakeholders as illustrated in **Figure 6** below. The endorsement mechanism was devised with the intention of being able to act expeditiously on Standards and Interpretations adopted by the IASB and the IFRS Interpretations Committee. It also provides a framework to deliberate, reflect, and exchange information on IFRS Accounting Standards among the main stakeholders, in particular national accounting standard setters, supervisors in the fields of securities, banking, and insurance, central banks including the ECB, the accounting profession, and users and preparers of accounts.

Figure 6. The process for endorsement of IFRS Accounting Standards in the EU



Source: Briefing: The Basis of the Endorsement Procedure for IFRS Accounting Standards, Economic and Monetary Affairs, European Parliament [100]

98 See https://www.efrag.org/en/financial-reporting/endorsement-status
99 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02008R1126-20230101
100 See https://www.europarl.europa.eu/RegData/etudes/BRIE/2016/578988/IPOL_BRI(2016)578988_EN.pdf

89. EFRAG's mission is to serve the European public interest in both financial and sustainability reporting by developing and promoting European views in the field of corporate reporting. EFRAG[101] is a private association established in 2001, with the encouragement of the European Commission, to serve the public interest by developing and promoting European views in the field of financial corporate reporting. It added a new role in 2022, assigned in the CSRD, of providing technical advice in the form of fully prepared draft ESRSs. It is funded by the Commission and its member organizations comprise European stakeholders, national organizations, and civil society organizations including, in the field of financial reporting: users, preparers, the accountancy profession, and national standard-setters. Its work related to financial reporting 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 Accounting Standards in Member States. When the IASB issues a new standard, EFRAG reviews and issues an opinion on it; EFRAG also elaborates an analysis on costs and benefits of each single IFRS Accounting Standard for both EU users and preparers and forwards the documents to the Commission. EFRAG includes within its structure a Financial Reporting Technical Expert Group, which conducts the majority of the technical evaluation and advice, and a financial reporting board, to ensure European interest and legitimacy. EFRAG also has an administrative board for supervision, governance oversight, due process oversight, nominations, and financial and budgetary matters.

90. The Accounting Regulatory Committee[102] was established by Article 6 of Regulation 1606/2002 to provide the European Commission with an opinion on proposals to endorse new IFRS Accounting Standards and amendments thereto. It is composed of high-level Member State representatives, mainly from Ministries of Finance, and is chaired by the Commission. The Accounting Regulatory Committee decides on the applicability of the IFRS Accounting Standards within the EU based on existing Member State and Community legislation.

91. The European Commission receives the technical opinion from EFRAG. The Commission then makes a proposal to either adopt or reject the Standard (or amendment) and submits this proposal directly to the Accounting Regulatory Committee along with a report detailing the Standard and its conformity with the existing accounting directives. The Commission can endorse the Standard if:

- the Accounting Regulatory Committee approves the Standard and the European Parliament and the Council do not oppose; or
- in the event the Accounting Regulatory Committee does not approve the standard, the Commission may override this with support from the Council and the European Parliament.

92. When the Accounting Regulatory Committee issues a positive opinion on a Standard, the Commission then forwards it to the Parliament and to the Council, which have a three-month period to scrutinize the Standard. Should the Parliament or the Council oppose the proposed Standard, the Commission may not adopt it.

101 See http://www.efrag.org/

102 See https://finance.ec.europa.eu/regulation-and-supervision/expert-groups-comitology-and-other-committees/accounting-regulatory-committee_en

Proper enforcement

93. The European Commission recognized that only properly enforced IFRS Accounting Standards would bring about the expected policy objectives (see paragraph 82). Proper enforcement was one of the pre-conditions for the US Securities and Exchange Commission to eliminate the need for reconciliation between IFRS and US Generally Accepted Accounting Principles for European companies issuing securities on US capital markets.

94. In this context, Regulation 1606/2002 requires Member States to take appropriate measures to ensure compliance with IFRS Accounting Standards. ESMA has developed a common European approach to enforcement included in *Guidelines on Enforcement of Financial Information*.[103] 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 in yearly enforcement reports.[104]

Interaction between Regulation 1606/2002 and the Accounting Directive

95. With the adoption of the Regulation 1606/2002 and the subsequent endorsement of individual standards, IFRS Accounting Standards have become part of the EU acquis. The Regulation does not have precedence over the Accounting Directive which co-exists with the Regulation. However, since the Accounting Directive applies to companies through its transposition into national law, there is no direct interaction between the Accounting Directive and the Regulation; only the latter is directly applicable to companies. Specifically, the interaction is one between national law and Regulation 1606/2002.

96. 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 Directive 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).

Other relevant financial market directives

97. The EU regards transparency of publicly traded companies' activities as being essential for the proper functioning of capital markets. Investors need reliable and timely

103 See https://www.esma.europa.eu/document/guidelines-enforcement-financial-information

104 See https://www.esma.europa.eu/sites/default/files/2024-03/ESMA32-193237008-8269_2023_Corporate_reporting_enforcement_and_regulatory_activities_report.pdf

information about the business performance and assets of the companies they invest in.[105] The **Transparency Directive** (2004/109/EC)[106] sets out the EU's special reporting rules for issuers with securities admitted to trading on regulated markets. 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.

98. The annual financial report must include the audited financial statements, the management report with 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. Where the issuer is required to prepare consolidated accounts, the audited financial statements shall be drawn up in accordance with IFRS Accounting Standards. Some exceptions are authorized, however, when accounting standards of the third county where the issuer is established are considered to be equivalent (see paragraph 102).

99. Quarterly financial reporting generated controversial discussions and ultimately a modification of the Transparency Directive in 2013. The initial text of the Directive did not explicitly mandate quarterly information and, even though experience in the US and in some Member States suggested that quarterly information would improve investors' protection, another decision was ultimately adopted. In order to reduce the administrative burden and to encourage long term investment, Member States are not required to demand quarterly financial information, though they have the power to require issuers to publish additional periodic financial information on a more frequent basis if certain conditions are met. Where the issuer is required to prepare consolidated accounts, the condensed set of financial statements shall be prepared.

100. The Prospectus Directive (2017/1129/EU)[107] regulates the drawing up and the publication of prospectuses when securities are offered to the public 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 other Member State with the production of a prospectus drawn up and approved in one Member State.

105 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/transparency-requirements-listed-companies_en

106 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32004L0109

107 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02017R1129-20240109

101. The Prospectus Directive requires that issuers include consolidated accounts prepared in conformity with the requirements of Regulation 1606/2002, i.e., endorsed IFRS Accounting Standards. Some exceptions are authorized when accounting standards of the third country where the issuer of securities is incorporated are considered to be equivalent.

102. Regarding equivalence mechanisms, both the Transparency Directive and the Prospectus Directive establish that accounting standards applied by third country issuers of securities are acceptable only if they have been determined by the EU to be equivalent to those endorsed in the EU. The objective is to facilitate cross-border listings and allow foreign companies listed on EU markets to prepare their financial statements in accordance with IFRS Accounting Standards or any other standard which has been declared equivalent to IFRS Accounting Standards. The mechanism for the determination of equivalence is described in the Commission's Regulation (1569/2007/EC).[108] 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 European Commission on the basis of technical advice from the European Supervisory Authorities (EBA, ESMA, or EIOPA) including a consideration of the convergence program or the progress towards adoption of IFRS Accounting Standards.

103. The European Commission maintains a website that shows the results of its determinations on the equivalence of non-EU countries' regulatory or supervisory regimes.[109] The equivalence of a third country issuer's financial statements is determined by reference to the International Accounting Standards Regulation via Transparency Directive and five countries: Canada, China, Japan, South Korea and the US are equivalent Generally, financial statements of third country issuers of securities will be considered equivalent in the EU if they have been prepared in accordance with IFRS Accounting Standards and audited by auditors operating in a public oversight system deemed equivalent by the CEAOB to that of the EU (see below paragraphs 107 and following).

C. Auditing: the acquis communautaire as it applies to corporate sector auditing

104. The two main legislative instruments governing statutory audits in the EU are Directive 2006/43/EC[110] on Statutory Audits of Annual Accounts and Consolidated Accounts, with significant amendments by Directive 2014/56/EU,[111] and also by Directive 2022/2464 concerning CSRD, and Directive 2023/2864 concerning European single access point (together referred to in the singular as the Audit Directive) and Regulation 537/2014[112] on Specific Requirements regarding Statutory Audits of Public Interest Entities (the Audit Regulation).

108 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02007R1569-20150101

109 See https://finance.ec.europa.eu/eu-and-world/equivalence-non-eu-financial-frameworks_en and https://finance.ec.europa.eu/document/download/013005aa-8040-4b1e-b518-bc76b5bb9ba7_en?filename=overview-table-equivalence-decisions_en.pdf

110 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32006L0043

111 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0056 and https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:02006L0043-20240109&qid=1722015593951

112 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014R0537-20240109 and https://eur-lex.europa.eu/EN/legal-content/summary/rules-for-statutory-audit-of-public-interest-entities.html?fromSummary=14

105. The overall objective of Directive 2006/43/EC as originally enacted 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 single 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 dealt with the approval of auditors from third countries and the registration of audit firms from third countries.

106. The reform of the audit regulatory framework that led to the 2014 Audit Directive and the Audit Regulation, emerged in the aftermath of the financial crisis. As emphasized by the Commission in its Green Paper on audit policy in 2010,[113] "the fact that numerous banks revealed huge losses from 2007 to 2009 on the positions they had held both on and off-balance sheet raises not only the question of how auditors could give clean audit reports to their clients for those periods, but also about the suitability and adequacy of the current legislative framework". Following the bankruptcies of Enron and Lehman Brothers, the independence of auditors from their main clients was questioned at international level, especially the practice of certifying annual accounts while providing other advisory services to the same clients, as was the hyper-concentration of the global audit market (from six ultra-dominant players to four, following the bankruptcy of Arthur Andersen and merger of Price Waterhouse with Coopers & Lybrand). Thus, the reform had four objectives: enhance transparency for investors; reinforce independence of auditors towards their clients; promote competition in a highly concentrated market dominated by the 'Big Four'; and strengthen pan-EU supervision. In 2022, the European Commission commissioned an in-depth study[114] to provide data and to analyze the impact of the transposition and implementation of specific provisions of the revised 2014 Audit Directive and Audit Regulation on achieving the reform's objectives. The key conclusions from that study are in Chapter 3. D. below).

Legislative approach

107. The Audit Directive 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 Audit Regulation established, amongst other things, the CEAOB (see paragraph 19) with the general remit to organize cooperation between national audit oversight bodies at EU level.

108. In line with the principle of proportionality, the Audit Regulation sets out more stringent and/or additional requirements for the statutory audits of public interest entities.

113 See https://www.europarl.europa.eu/meetdocs/2009_2014/documents/com/com_com(2010)0561_/com_com(2010)0561_en.pdf

114 Study on the Audit Directive (Directive 2006/43/EC as amended by Directive 2014/56/EU) and the Audit Regulation (Regulation (EU) 537/2014) Final Report download from https://op.europa.eu/en/publication-detail/-/publication/1e77fe60-71f5-11ed-9887-01aa75ed71a1/language-en

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, and external quality assurance and oversight. The Audit Directive defines public interest entities as publicly traded companies, banks, and insurance undertakings. It allows Member States to expand the definition of public interest entities.

109. 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

110. The Audit Directive establishes the minimum requirements on education and training. The education and training cycle includes university entrance or the equivalent level, the completion of theoretical instruction, three years of practical training, of which two years 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

111. 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 competent authorities of the Member States should cooperate within the framework of the CEAOB to 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 (Audit Directive, Article 14).

112. The Audit Directive 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 requirement should not exceed 75% of the members). This is to ensure that the statutory audits cannot be compromised by other commercial interests or undue influence.

113. 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

114. The Audit Directive includes stipulations on professional ethics (public interest, integrity, objectivity, and professional competence), independence, and confidentiality / professional secrecy. These provisions are broadly similar to the International Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants.[115] 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 apply to auditors of public interest entities.

115. The Audit Directive requires statutory auditors to self-assess the risks to their independence and apply appropriate mitigating safeguards (Article 22). Independence rules apply (at least) during 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 interest 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. Further, the Audit Directive requires that 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.

117. The Audit Regulation adds further requirements for statutory auditors of public interest entities including prohibiting statutory auditors from providing specified prohibited non-audit services to strengthen auditor independence. 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 resource 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 EU.

115 See https://www.ethicsboard.org/publications/2024-handbook-international-code-ethics-professional-accountants

118. Before accepting or continuing an engagement for a statutory audit of a public interest entity, a statutory auditor or audit firm shall assess and document its independence and, more specifically, compliance with the provisions of the Audit 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 independence is complemented 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

119. The 2014 Audit Directive states that “Member States shall require that statutory auditors and audit firms comply with international auditing standards adopted” by the European Commission. Although the Commission has yet not adopted the International Standards on Auditing (ISA), in practice, 26 out of 27 Member States (France being the exception) have adopted ISAs. Article 26.3 of the Audit Directive (2014) sets out preconditions for ISAs 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 ISAs 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 ISAs only if those audit procedures or requirements stem from specific national legal requirements relating to the scope of statutory audits.

120. The proportionality of ISAs was heavily debated in the EU and globally. Some auditors argued that their application in smaller undertakings would be difficult and increase costs. Furthermore, in some countries, limited assurance of the accounts of small undertakings have been accepted instead of a statutory audit. In December 2023, the International Auditing and Assurance Standards Board issued the International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCEs).[116] This new stand-alone standard contains all requirements necessary to obtain reasonable assurance about whether the financial statements of less complex entities as a whole are free from material misstatements, whether due to fraud or error. The standard is designed to be proportionate and tailored to the specific needs of an audit of less complex entities while being based on the underlying concepts from full ISAs. It is intended to: maintain confidence in financial reporting of less complex entities; help their auditors deliver consistent and effective high-quality audits; be responsive to stakeholder needs; and promote consistent application of the auditing standards to audits of less complex entities.

116 See https://www.iaasb.org/publications/international-standard-auditing-audits-financial-statements-less-complex-entities

The standard is effective for audits of financial statements for periods beginning on or after December 15, 2025. While adoption of ISA for LCEs by the Commission is rather unlikely given the unfavorable view of CEAOB,[117] individual Member States can consider whether to allow or require application of the standard in their jurisdictions.

121. The Audit Directive contains 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.

122. Article 28 of the Audit Directive defines the structure of audit reports and the types of audit opinion. It confirms that the report should be prepared in accordance with the requirements of the international auditing standards adopted by the EU or Member States. 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.

123. The Audit Regulation requires the auditor of a public interest entity to take action when they suspect, or have reasonable grounds to suspect, irregularities including fraud with regard to the financial statements of the audited entity. Specifically, the auditor should "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 investigate the matter, the auditor has a duty to inform the authorities.

124. The Audit Regulation also requires the auditor of a public interest entity to submit an additional report to the public interest entities' audit committee to explain the results of the audit and a variety of matters set out in Article 11 including: the 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

125. The International Standard on Quality Control Management (ISQM1) issued by the International Auditing and Assurance Standards Board requires audit firms to comply with a number of principles of good governance. Article 8 of the Audit Regulation includes most of these principles. 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 8 imposes extensive documentation requirements.

117 See https://finance.ec.europa.eu/document/download/937a7cac-b034-4fe2-a642-5a03f2e29e78_en?filename=230502-ceaob-comment-letter-iaasb-isa-lce-group-audit_en.pdf)

126. The Audit Regulation requires firms that audit public interest entities to 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.

127. Article 32 of the Audit Directive and Article 23 of the Audit Regulation obliges Member States to organize an effective system of public oversight covering all statutory auditors and audit firms. The Directive defines the scope of the quality review/inspection as well 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. The Audit Directive requires that quality assurance inspections take place at least every six years whereas the Audit Regulation requires this to take place at least every three years in respect of statutory auditors of public interest entities, with the overall results being published annually and, where needed, followed up on.

128. When carrying out quality assurance reviews of the statutory audits of annual or consolidated financial statements, recital 24 of the Audit Regulation refers to Commission Recommendation 2008/362/EC[118] of May 6, 2008, on external quality assurance for statutory auditors and audit firms of public interest entities, which provides information on how inspections should be undertaken. It specifically states that quality assurance reviews should be appropriate and proportionate to the scale and complexity of the business of the reviewed statutory auditor or audit firm.

System of public oversight

129. 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. ESMA maintains a list of competent authorities in charge of public oversight activities in EU Member States and European Economic Area (EEA) countries.[119]

130. Across the globe, there are two main models of public oversight: direct oversight of statutory auditors and audit firms by an independent (public) body, or indirect oversight where an independent (public) body has ultimate oversight responsibility but can delegate some of these responsibilities to professional or other bodies. As suggested by Commission Recommendation 2008/362/EC on External Quality Assurance (see above paragraph 128 and following), the oversight system of firms auditing public interest entities is a direct oversight system, permitting the contracting of experts to carry out specific inspections but prohibiting those experts who are involved in the governance of, or employed or otherwise contracted by, professional associations and bodies (Article 26 of the Audit Regulation). However, delegation remains possible for the oversight of other statutory auditors and audit firms.

118 See https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ%3AL%3A2008%3A120%3A0020%3A0024%3AEN%3APDF

119 At the time of this publication, the latest list of competent authorities is at January 12, 2023, and can be found here https://www.esma.europa.eu/sites/default/files/audit_regulation.pdf

131. Supervision of audit networks and audit firms that have cross-border activities requires the public oversight authorities of Member States to exchange information and to coordinate their operations at EU level and with third countries. The CEAOB established by the Audit Regulation is 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 public interest entities

132. To keep sufficient 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 management. The Audit 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.

133. Public interest entities must have an audit committee with specified tasks, such as monitoring the financial reporting process and statutory audit. The audit committee is an important 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.

134. One of the objectives of the 2014 audit reform was to improve market conditions. To that end, as far as public interest entities 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

135. 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 110).

136. 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.

Assurance on sustainability reporting

137. Chapter 2. A. describes the EU's framework for sustainability reporting and the phased introduction of the 12 ESRSs endorsed in July 2023 with the timetable for their adoption by various types of entities. The CSRD that led to the development of the ESRSs also requires assurance on sustainability reporting. The European Commission envisages two types of assurance:[120] limited assurance whereby the conclusion is normally provided in a negative form of expression by stating that no matter has been identified by the practitioner to conclude that the matter is materially misstated; and reasonable assurance whereby the conclusion is usually provided in a positive form of expression and results in providing an opinion on the measurement of the subject matter against previously defined criteria.

138. The European Commission proposes a so-called progressive approach whereby they will start by requiring limited assurance on sustainability reporting before [possibly] moving to requiring reasonable assurance. The European Commission intends, no later than October 1, 2026, to provide limited assurance standards setting out the procedures to be performed in order to draw conclusions on the assurance of sustainability reporting, including engagement planning, risk consideration, and response to risks and type of conclusions to be included in the assurance report on sustainability reporting, or, where relevant, in the audit report. The European Commission also intends, no later than October 1, 2028, to provide for reasonable assurance standards, following an assessment to determine if reasonable assurance is feasible for auditors and for undertakings.

139. Member States may choose to allow assurance over sustainability reporting to be separate from the financial statement audit, i.e., by a separate auditor or independent assurance provider. **Figure 3** shows the European Commission's progressive approach to the requirement for assurance on sustainability reporting.

140. The European Commission package of proposals in relation to the Competitiveness Compass,[121] if adopted, will have a significant impact on the assurance framework applicable to corporate sustainability reporting, particularly in respect of: removing the possibility of moving from a requirement for limited assurance to a requirement for reasonable assurance; and issuing targeted assurance guidelines by 2026 instead of an obligation for the Commission to adopt standards for sustainability assurance by 2026. Further information on the Compass roadmap as well as the new package of proposals is in paragraphs 154 below.

120 See recital 60 of the CSRD, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464

121 See press release announcing the EU Competitive Compass https://ec.europa.eu/commission/presscorner/detail/en/ip_25_339

3

Beyond the Acquis

141. The EU has made great strides in harmonizing Member States' corporate sector accounting, sustainability reporting, and auditing frameworks. That said, there are a number of initiatives and studies being considered in the preparation of further Commission initiatives in these areas that could, subject to due legislative process in the EU, lead to further changes. These are summarized below together with their recommendations or directions: (A) Corporate Sustainability Reporting; (B) 2022 European Commission public consultation on strengthening the quality of corporate reporting and its enforcement; (C) 2021 European Commission Fitness Check on the EU framework for public reporting by companies; (D) 2022 European Commission report on the operation of the European Supervisory Authorities; (E) 2022 European Commission-commissioned study on the 2014 revised Audit Directive and Audit Regulation; (F) 2023 New Growth Plan for the Western Balkans; and (G) 2025 EU Competitiveness Compass.

A. Phasing and simplifying corporate sustainability reporting

142. As discussed above in paragraphs 23, 55-59 and 137-139, the 2022 CSRD[122] requires a broad set of large companies, as well as listed SMEs, to report on sustainability in accordance with ESRS developed by EFRAG and published in December 2023 under the form of a delegated regulation.[123] The first companies that have to apply the new ESRS will do so for the first time in the 2024 financial year, for reports published in 2025.

143. The EU is considerably ahead of other jurisdictions in terms of sustainability reporting in that the European Commission has already issued a first set of 12 mandatory ESRSs (two general and ten topical), approved by the Commission in July 2023 annexed to Delegated Regulation 20223/2772.[124] In December 2024, EFRAG released the VSME.[125] EFRAG is

122 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464

123 See https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32023R2772

124 See https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32023R2772

125 See https://www.efrag.org/en/news-and-calendar/news/efrag-releases-the-voluntary-sustainability-reporting-standard-for-nonlisted-smes-vsme

expected to develop and publish additional sets of EFRSs in due course to include sector-specific standards and a standard on non-EU parent companies. By comparison, at the time of writing this guide, the IFRS Foundation's International Sustainability Standards Board had only issued two sustainability disclosure standards[126] of significantly less scope than ESRSs.

144. The CSRD also requires assurance on sustainability reporting. The European Commission envisages two types of assurance:[127] limited assurance whereby the conclusion is normally provided in a negative form of expression by stating that no matter has been identified by the practitioner to conclude that the matter is materially misstated; and reasonable assurance whereby the conclusion is usually provided in a positive form of expression and results in providing an opinion on the measurement of the subject matter against previously defined criteria.

145. The European Commission proposes a progressive approach, initially requiring limited assurance on sustainability reporting before [possibly] moving to requiring reasonable assurance. The Commission intends, no later than October 1, 2026, to provide limited assurance standards and, no later than October 1, 2028, to provide for reasonable assurance standards, following an assessment to determine if reasonable assurance is feasible for auditors and for undertakings. **Once changes in the sustainability reporting requirements are officially adopted by the European Parliament and Council, this guide will be updated accordingly.**

146. The Commission package of proposals in relation to the Competitiveness Compass, if adopted, include measures to simplify the framework and reduce the burden in the following ways:

i. The number of undertakings subject to mandatory sustainability reporting requirements would be reduced by about 80%, taking out of scope large undertakings with up to 1,000 employees (i.e. some of the undertakings from the second wave and some of the undertakings from the first wave) and listed SMEs (i.e. all undertakings in the third wave). The reporting requirements would only apply to large undertakings with more than 1,000 employees on average (i.e. undertakings that have more than 1,000 employees and either a turnover above EUR 50 million or a balance sheet above EUR 25 million). This revised threshold would align the CSRD more closely with the Directive on Corporate Sustainability Due Diligence.

ii. For undertakings not subject to mandatory sustainability reporting requirements, the Commission proposes a proportionate standard for voluntary use which would be based on the VSME standard developed by EFRAG. According to this proposal, the Commission would adopt this voluntary standard as a delegated act. In the meantime, to address market demand, the Commission intends to issue a recommendation on voluntary sustainability reporting as soon as possible, based on the VSME standard developed by EFRAG.

iii. The value-chain cap would be extended and strengthened. It would apply directly to the reporting company instead of being only a limit on what ESRS can specify. It would protect all undertakings with up to 1,000 employees rather than just SMEs as is currently the case. And the limit would be defined by the voluntary standard adopted by the Commission as a delegated act, based on the VSME standard developed by EFRAG. This would substantially reduce the trickle-down effect.

126 See https://cdn.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/

127 See recital 60 of the CSRD, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464

iv. There would be no sector-specific reporting standards, so avoiding an increase in the number of prescribed datapoints that undertakings should report.

v. The possibility of moving from a requirement for limited assurance to a requirement for reasonable assurance would be removed. This would provide clarity that there will be no future increase in costs of assurance for undertakings in scope.

vi. Instead of an obligation for the Commission to adopt standards for sustainability assurance by 2026, the Commission would issue targeted assurance guidelines by 2026. This would allow the Commission to more quickly address emerging issues in the field of sustainability assurance that may be generating unnecessary burdens on undertakings that are subject to the reporting requirements.

vii. The proposal introduces an "opt-in" regime for large undertakings. Undertakings that have more than 1,000 employees and either a turnover above EUR 50 million or a balance sheet above EUR 25 million and a net turnover not exceeding EUR 450 million which claim that their activities are aligned or partially aligned with the EU taxonomy shall disclose their turnover and capital expenditure key performance indicators and may choose to disclose their operating expenses key performance indicators. This "opt-in" approach will eliminate entirely the cost of compliance with the taxonomy reporting rules for these large undertakings which do not claim that their activities are associated with economic activities that qualify as environmentally sustainable under the Taxonomy Regulation. In addition, this proposal provides more flexibility by allowing these undertakings to report on activities that meet certain Taxonomy technical screening criteria without meeting all of them. Such reporting on partial alignment can foster a gradual environmental transition of activities overtime, in line with the aim to scale up transition finance.

147. The Commission also announced its intention to adopt without delay a delegated act to revise the first set of ESRS. To deliver swiftly on the simplification and streamlining of the ESRS, and to provide clarity and legal certainty to undertakings, the Commission aims to adopt the necessary delegated act as soon as possible, and at the latest six months after the entry into force of the Directive to simplify the reporting framework that is the subject of the separate legislative proposal referred to above. The revision of the delegated act will substantially reduce the number of mandatory ESRS datapoints by (i) removing those deemed least important for general purpose sustainability reporting, (ii) prioritizing quantitative datapoints over narrative text, and (iii) further distinguishing between mandatory and voluntary datapoints, without undermining interoperability with global reporting standards and without prejudice to the materiality assessment of each undertaking. The revision will clarify provisions that are deemed unclear. It will improve consistency with other pieces of EU legislation. It will provide clearer instructions on how to apply the materiality principle to ensure that undertakings only report material information and to reduce the risk that assurance service providers inadvertently encourage undertakings to report information that is not necessary or dedicate excessive resources to the materiality assessment process. It will simplify the structure and presentation of the standards. It will further enhance the already very high degree of interoperability with global sustainability reporting standards. It will also make any other modifications that may be considered necessary considering the experience of the first application of ESRS.

148. Finally, the Commission announced its proposal to postpone by two years the entry into application of the reporting requirements for the second wave (large undertakings

that are not public interest entities and that have more than 500 employees, as well as large undertakings with fewer than 500 employees) and the third wave (listed SMEs, small and non-complex credit institutions, and captive insurance and reinsurance undertakings). The objective of the postponement is to avoid a situation in which certain undertakings are required to report for fiscal year 2025 (second wave) or 2026 (third wave) and are then subsequently relieved of this requirement. Such a situation would mean that the undertakings in question incur unnecessary and avoidable costs.

B. 2022 European Commission public consultation on strengthening the quality of corporate reporting and its enforcement

149. In November 2021, the European Commission launched a public consultation[128] with a view to: (i) assessing problems with the quality of corporate reporting; and (ii) comparing possible options to remedy these problems. The 2022 summary report of the public consultation noted the following in respect of the main themes:

- **The EU framework for high quality and reliable corporate reporting.**
  - Taking all the components of the EU eco-system as a whole, respondents found the EU framework for corporate reporting overall rather effective.
  - Stakeholders identified weaknesses in its efficiency and coherence; they considered corporate governance was the weakest area with overall low/medium effectiveness and efficiency. Conversely, preparers of corporate reporting considered the corporate governance as highly or very highly effective.
  - Concerning the supervision by public authorities of statutory auditors/audit firms, respondents considered this to be rather effective, efficient, and coherent.
  - In general, respondents rather/strongly agreed that stakeholders such as companies, statutory auditors, supervisors, and the EU should take action to improve the quality of corporate reporting.
- **Corporate governance.**
  - As regards the effectiveness, efficiency, and coherence of boards' responsibility and liability, the majority of respondents viewed them as either low or medium. While auditors were particularly negative about these elements, preparers found the framework to be effective (88% medium/high).
  - Views were quite divergent on requirements related to audit committees (establishment obligation, rules on composition/tasks, and its external position). However, around 80% of respondents considered the effectiveness, efficiency, and coherence of the tasks of audit committees as either medium, high, or very high.
  - On the question whether material departures from IFRS Accounting Standards could be attributed to deficiencies of the EU framework on corporate governance, 71% responded that this was not the case at all or only to a limited extent.

128 See https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13128-Corporate-reporting-improving-its-quality-and-enforcement/public-consultation_en.

- A large majority of respondents, and especially accountants, audit professionals, and supervisors, agreed/strongly agreed on the need for improvement of the corporate governance pillar.
- There was also overall support for strengthening, clarifying, and harmonizing responsibilities of boards of directors; ensuring effective risk management and internal controls; and ensuring proper expertise of board members.
- Among possible other actions, various respondents suggested that the audit committee should provide assurance on internal control systems or establish an internal audit committee to provide assurance over internal processes.

Statutory audit.

- Respondents considered the EU framework on statutory audit overall as effective, but not necessarily efficient and coherent. Over 82% of respondents rather or strongly agreed that statutory audits contribute as much as possible to the quality and reliability of corporate reporting by public interest entities. They also considered that the work of auditors was reliable and were satisfied with the role of public interest entity statutory auditors.
- Many respondents highlighted the lack of harmonization of the rules for statutory audit across the EU and called for harmonization and simplification by the removal of the Member State option.
- Respondents had diverging views on many of the measures proposed in the consultation paper on how to improve audit quality. In particular, views were quite split on the statement that joint audits contribute to the quality of audit.
- Respondents overall were rather supportive of further harmonizing the rules on mandatory rotation (63% rather effective/efficient or very effective/efficient). Many respondents were in favor of limiting Member States' national options in the EU audit framework in order to ensure consistency across the EU and to incentivize cross-border statutory audits.

Supervision of public interest entities' statutory auditors and audit firms.

- Respondents considered the supervision of public interest entity auditors and Member States' systems of investigations and sanctions to be generally effective, efficient, and coherent.
- Respondents had generally divergent views on many of the possible measures aiming to improve the quality of supervision. Nevertheless, respondents voiced strong support for increased consistency of supervision of cross-border networks of audit firms. On the other hand, a majority of respondents (52%) replied that giving a European body responsibility to register and supervise public interest entity statutory auditors and audit firms was neither effective nor efficient.

Supervision and enforcement of corporate reporting.

- A majority of respondents considered the EU framework for supervision and enforcement of corporate reporting as overall medium to highly effective and relevant. They did not consider the latter as necessarily efficient.
- National supervisors had split views about reinforcing the powers of ESMA, noting that a single rulebook on certain enforcement activities could be more effective, especially for the benefit of multinational companies and networks of auditors. Nevertheless, ESMA could play a role in coordinating and providing guidelines and interpretations to the National Competent Authorities.

C. 2021 European Commission fitness check on the EU framework for public reporting by companies

150. In April 2021, the European Commission published a working document, Fitness Check on the EU Framework for Public Reporting by Companies[129] to assess primarily whether the EU framework achieved its immediate objective of providing stakeholders with financial and non-financial information sufficient in quantity and quality to enable them to make informed decisions and protect their interests, make investment decisions, or hold companies publicly accountable. This immediate objective was assessed against four qualitative criteria: relevance, reliability, comparability, and timeliness of published information. Although it was beyond the scope of the Fitness Check to put forward follow-up action, the working document nevertheless highlighted some of the main areas for improvement to the EU framework.

- Overall, EU-level public reporting requirements for financial information are fit-for-purpose, in that they are largely effective, highly relevant, coherent, and bring EU value added, albeit of questionable value for micro companies. As regards limited liability companies in general, more could be done to ensure prompt publication of financial information.
- Ways to promote the use of IFRS Accounting Standards could be assessed to improve EU-wide comparability for larger non-listed companies (2% of companies). The EU framework on public reporting for non-financial information is relatively recent, but its requirements and public reporting practices are not commensurate with the EU's ambition to become a sustainable economy and society.
- The International Accounting Standards Regulation appears to be the most effective instrument in ensuring comparable and complete financial information across Europe. Based on further consultation with all stakeholders, a comprehensive cost-benefit analysis could be carried out to assess whether to expand the scope of EU-endorsed IFRS Accounting Standards to all companies listed on regulated markets and, as a company option, to SMEs that plan to issue securities or to larger, non-listed companies.
- Further digitalization of public reporting could significantly increase user efficiency, both for financial and non-financial information. Lastly, further convergence of supervisory practices across the EU must remain a priority to improve the comparability and reliability of public reporting by companies.

D. 2022 European Commission study on the 2014 revised Audit Directive and Audit Regulation

151. The reform of the audit regulatory framework that led to the revised 2014 Audit Directive and Audit Regulation had four objectives: enhance transparency for investors;

129 See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021SC0081

reinforce independence of auditors towards their clients; promote competition in a highly concentrated market dominated by the 'Big Four'; and strengthen pan-EU supervision. In 2022, the European Commission commissioned an in-depth study to provide data and to analyze the impact of the transposition and implementation of specific provisions of the revised 2014 Audit Directive and Audit Regulation on achieving the reform's objectives.[130] These provisions include assurance and reporting requirements for statutory auditors, mandatory rotation and appointment of auditors, prohibition of certain non-audit services, and caps on fees for non-audit services. With a view to giving an indication of the issues that might be addressed in further reforms of the EU framework for corporate sector auditing, the main findings of the study were:

- Despite some clear improvements in the harmonization of the national frameworks, significant disparities remain between countries in the transposition, implementation, and enforcement of EU audit legislation (e.g., audit requirements that apply to different types of undertakings, rotation requirements, investigations, sanction regimes).
- The majority of audit reports for public interest entities are led by members of the Big Four. The audit reports do not contain information about corporate governance practices applied over and above the national requirements. The analyzed audit reports appear not to go beyond the EU legal requirements. Compliance issues identified in the reports concern requirements related to the management report and the corporate governance statement. Analysis of audit committees' compliance (based on self-assessment) with the Audit Regulation on additional reports shows that audit committee reports for most public interest entities appear mostly in line with the regulatory requirements. However, about two-thirds of audit committee reports have one or more deficiencies. Significant deficiencies in the audited financial statements are an exception. On the appointment of statutory auditors, more than half of the auditors changed their audit firm or statutory auditor in the period between 2016 and 2020. The large majority of companies in the sample preferred to have the same audit firm for all companies in their corporate group.
- The reform effectively increased levels of independence but did not impact competition as intended. The switch across different types of auditors has been limited, with a persistently high market share for the Big Four. Hence, the non-Big Four audit firms are often invited to participate in the tender procedures, but the more complex the company concerned (size, structure, geographical coverage, etc.), the less likely they are to participate and receive the assignment. Nevertheless, the mandatory rotation, according to audit committee representatives and to a lesser extent the auditors, has contributed to improved quality of the audit services, independence of the auditors, and competition between audit firms.
- Of the 234 audited firms that exceeded the cap on fees for non-audit services in 2015, more than half reduced their non-audit fees to below the cap by 2018. Nevertheless, an additional 84 firms exceeded the cap in 2018. Most undertakings have implemented more stringent internal limits on the use of non-audit services. This has - according to the audit committee representatives - delivered an important contribution to the independence of the auditors and to a lesser extent improvement in the quality. In turn, at least for some undertakings, it reduced the competition.
- The analysis of audit fees shows huge dispersion in the costs, as well as significant differences depending on the sector. Fees are significantly higher for public interest

130 Study on the Audit Directive (Directive 2006/43/EC as amended by Directive 2014/56/EU) and the Audit Regulation (Regulation (EU) 537/2014) Final Report download from https://op.europa.eu/en/publication-detail/-/publication/1e77fe60-71f5-11ed-9887-01aa75ed71a1/language-en

entities than for non- public interest entity audits. Nevertheless, most of the undertakings that did not conduct regular tender procedures before witnessed a decrease in costs.

E. 2022 European Commission report on the operation of the European Supervisory Authorities

152. In May 2022, the European Commission published a report on the operation of the European Supervisory Authorities taking into account the results of a public consultation launched in 2021.[131] The focus of the review was on whether – and to what extent – amendments to the European Supervisory Authorities Regulations which entered into application on January 1, 2020, had benefited EU financial supervision. In broad terms, respondents to the consultation gave a positive assessment of the impact of the European Supervisory Authorities on: (i) financial stability; (ii) the functioning of the internal market; (iii) the quality and consistency of supervision; (iv) the strengthening of international supervisory coordination; (v) consumer and investor protection; (vi) sustainable finance; and (vii) digital finance. Many respondents observed that it was still too soon to: (i) evaluate fully the changes that were agreed in 2019 and that had only entered into application in early 2020; and (ii) consider further changes given the short period of time since the implementation of the last amendments. The report summarized the findings from the consultation and from other stakeholder contacts and presented the Commission's assessment on the following areas:

- **Supervisory convergence**
  - The European Supervisory Authorities have made an important contribution to improving supervisory convergence through the use of their toolkit. In recent times, they have rightly started to shift the focus of their work from developing the single rulebook to achieving convergence in its application and supervision.
  - There may have been instances other than the ad-hoc peer review of the Wirecard case[132] where an ad-hoc peer review would have been warranted.
  - Some of the available tools might not have been used to their fullest to tackle supervisory discrepancies. For example, the procedure for breach of Union law has been very rarely used.
  - Taking into account the feedback from the consultation that more time is needed to fully assess the impact of the recent changes, the Commission would not now propose changes to the European Supervisory Authorities Regulations to strengthen supervisory convergence. Instead, it continued to encourage the Authorities to make good use of the existing instruments. The Commission invited the European Supervisory Authorities to assess further improvements that could

131 See https://finance.ec.europa.eu/regulation-and-supervision/european-system-financial-supervision_en#review and https://finance.ec.europa.eu/publications/report-operation-european-supervisory-authorities_en

132 ESMA conducted an ad-hoc peer review to assess the supervisory response in the financial-reporting area by BaFin and the Financial Reporting Enforcement Panel to the events leading to the collapse of Wirecard AG. The peer review identified a number of shortcomings.

be implemented in the short term and that would not require any change to the legislative framework such as:

- increased transparency on how rules are applied across the EU;
- increased focus on enforcement in supervisory convergence tools to foster the consistent application of enforcement measures, including sanctions;
- the possibility of carrying out ad-hoc peer reviews of competent authorities in case of events with major supervisory implications could be used to a greater extent as an ex-post tool;
- the European Supervisory Authorities could also explore to what extent informal tools developed by each other might be usefully incorporated into their own supervisory convergence toolbox; and
- discussion of supervisory cases among National Competent Authorities in a more systematic way could be useful to promote convergent supervisory outcomes in comparable situations.

- **Governance**
  - The Commission agreed that the amendments set out in the 2019 European Supervisory Authorities review were a step in the right direction and should have a positive overall impact on the governance of the European Supervisory Authorities. But despite these changes, the Commission continued to believe that the governance system of the Authorities, with decisions being taken by the 27 national supervisors, may still give too much prominence to national interests and occasionally produce sub-optimal results.
  - The Commission will consider the need for a targeted change to governance of the EBA in order to ensure a more consistent separation of its resolution and prudential functions.
  - The Commission invited the European Supervisory Authorities to reflect on the following suggestions:
    - Improve transparency on the timing and content of decisions by the Board of Supervisors by publishing the part of their agendas which concern regulatory items;
    - Further increase their interaction with stakeholders by engaging more in an ongoing dialogue;
    - Make further progress in the new task of monitoring and fostering supervisory independence by further developing the principles of independence and drawing up cross-sectoral criteria for supervisory independence in the EU;
    - Given the increasing number of cross-sectoral tasks and topics that must be dealt with by the European Supervisory Authorities, which has tended to make the Joint Committee increasingly relevant, the Authorities could consider changes to the framework to ensure sufficient resources and improve the decision-making process; and
    - In the interest of greater efficiency, ESMA could consider whether there are further possibilities to delegate day-to day supervisory decisions for entities that are under its direct supervision to committees or to the chairperson.

Direct supervision

- In line with the action plan on Capital Markets Union, the Commission will consider proposing direct supervision by the European Supervisory Authorities should there be indications that the current supervisory set-up is not appropriate for the desired level of market integration;
- The Commission is looking at ways to address the financial-stability risk posed by overreliance on United Kingdom-based central clearing counterparties. It intends to come forward with measures to make EU-based central clearing counterparties more attractive, including by reviewing the EU supervisory system for them; and
- The Commission will consider the possibility of setting out different "modes" of direct supervision as a potential way forward in the area of direct supervision. One such mode could be the "hub-and-spoke" model, in which National Competent Authorities continue to play a significant role and use their knowledge of national specificities of markets and legal systems to benefit a central supervisory authority.

The Single Rulebook and the operation of the European Supervisory Authorities

- An "enhanced single rulebook" refers to more comprehensive and, where appropriate, more granular rules at different levels of EU legislation and guidance. On essential elements, this implies more EU rules set out in Level 1, namely regulations and directives. On non-essential elements, this implies more EU rules set out in delegated or implementing acts at Level 2. Further guidance and clarifications can then also be provided in guidelines or Q&As issued by the Authorities at Level 3. In addition, instead of directives, more harmonization can be obtained through directly applicable regulations at Level 1 for future sectoral legislation, or for existing legislation that comes up for review. Regulations might be a better choice than directives in this case, because directives generally leave Member States the choice of how to transpose the directive into national law. More harmonization could also be applied through different degrees of harmonization of either regulations or directives; or by allowing for fewer opt-outs from harmonized rules. The trade-off between Level 1 and Level 2 is also linked to the broader question of how to achieve speed, adaptability, and quality in legislation, which is particularly relevant for sectors undergoing fast transformation.
- The Commission does not intend to review existing EU financial services legislation solely with a view to introducing more granular rules at Level 1, or to removing provisions allowing national discretion. Regarding the need to ensure that EU legislation remains future proof and can easily adapt to accelerating technological and market developments, it is important for the co-legislators, wherever possible and appropriate, to lay down general principles in level 1 and more detailed rules in level 2. This would allow faster reactions to rapid market developments; and
- The Commission and the European Supervisory Authorities are already mitigating the burden on market participants through a high degree of transparency when they draw up technical advice and technical standards. This transparency enables market participants to start their preparations on the basis of drafts. The Commission acknowledges that certain provisions in legislative acts can be challenging to apply before delegated or implementing acts have been promulgated. It will work towards raising awareness of this problem, both with the co-legislators and with the European Supervisory Authorities.
  - Funding of European Supervisory Authorities. The Authorities' budgets are based on a 60% contribution from the National Competent Authorities and a 40% contribution from the EU budget. For ESMA, this distribution is slightly

different, as entities that are directly supervised by ESMA also pay supervisory fees to this agency.

- The Commission does not intend to propose legislative amendments to change the current legal framework for the Authorities' funding;
- To address the issue of supervisory fees and to ensure that fees remain reasonable in relation to the supervised entities' revenues, the Commission invites ESMA to explore the different options available within the current legal framework.

F. 2023 New growth plan for the Western Balkans

153. In 2023, the Commission reaffirmed its strong belief that enlargement remains a key policy of the European Union and in particular that full EU membership for the Western Balkans[133] is in the Union's very own political, security and economic interests. In respect of the latter, the Commission was of the view that while economic convergence is an essential element in getting the Western Balkan countries closer to the EU, the then level and speed of convergence between the Western Balkan partners and the EU was not satisfactory – either in terms of reform processes or of socio-economic convergence – and was holding back their progress on the EU track. The Commission therefore proposed to jump-start and incentivize the Western Balkans' preparations for EU membership by bringing forward some of its benefits especially in ways that can be felt directly by the citizens of the Western Balkan countries. This led to the Commission's 2023 WeBa Growth Plan proposal. This is based on the following four pillars:

i. **Enhancing economic integration with the EU single market**, subject to the Western Balkans aligning with single market rules and opening the relevant sectors and areas to all their neighbors at the same time, in line with the Common Regional Market.[134] The WeBA Growth Plan includes seven Priority Actions for Integration into the EU's single market of which the following is most likely to be of particular relevance to corporate sector accounting, sustainability reporting and auditing:

   - Free movement of services and workers. Recognition of skills and qualifications between the EU and the Western Balkans, including professional qualifications. Building on the four ground-breaking mobility agreements agreed in the context of the Common Regional Market[135] through enhanced co-operation, information exchange, and use of transparency tools - such as the European Qualifications Framework - to facilitate faster and more effective recognition of skills and qualifications. In particular, through promoting an effective implementation by Member States with regard to Western Balkan countries of the foreseen Commission recommendation on the recognition of qualifications of third-country nationals.

133 The six countries of the Western Balkans are: Albania, Bosnia and Herzegovina, Kosovo, North Macedonia, Montenegro, and Serbia.

134 The Common Regional Market, agreed by the leaders of the six Western Balkan countries at the Berlin Process summit in Sofia 2020, is intended to bring the four freedoms of movement (goods, services, capital and workers) within the region.

135 Recognition of Professional Qualifications of Doctors of Medicine, Doctors of Dental Medicine, and Architects in the CEFTA context; Recognition of Higher Education Qualifications; Mutual Recognition of Professional Qualifications for Nurses, Veterinary Surgeons, Pharmacists and Midwives; and Freedom of Movement with Identify Cards in the Western Balkans https://www.berlinprocess.de/uploads/documents/joint-agreement-recognition-of-professional-qualifications-nurses-veterinary-surgeons-midwives-and-pharmacists-bp-summit-2023_1697628897.pdf

ii. **Boosting economic integration within the Western Balkans through the Common Regional Market,** based on EU rules and standards, which the EU believes could potentially add 10% to their economies. The Common Regional Market[136] action plan sets out an extensive program of actions based on EU rules and standards, to establish the four freedoms of movement within the Western Balkans: goods, some services, capital, and workers. This is accompanied by a Green Agenda and a Digital and Innovation Agenda for the region. The EU will provide substantial opportunities for integration in the EU single market only if the region delivers on regional economic integration. Partners that are not fully committed to the Common Regional Market or impede the implementation of the Common Regional Market Action Plan cannot expect to benefit from the growth plan in terms of opportunities for single market integration (pillar 1).

iii. **Accelerating fundamental reforms, including on the fundamentals cluster,**[137] supporting the Western Balkans' path towards EU membership, improving sustainable economic growth including through attracting foreign investments, and strengthening regional stability. Every Western Balkan partner but Bosnia and Herzegovina has prepared a Reform Agenda based on existing recommendations including from the annual Enlargement Package and the conclusions of the Economic and Financial Dialogue, based on the countries' Economic Reform Programs. The Reform Agenda, validated by the Commission identified a limited set of priority reforms, broken down into qualitative and quantitative steps which will serve as payment conditions, i.e. upon achievement, they will trigger the release of funds under the new Reform and Growth Facility according to a pre-determined timeline. The World Bank supports the implementation of relevant milestones, including through the CFRR.

iv. **Increasing financial assistance to support the reforms through a Reform and Growth Facility for the Western Balkans**, a new instrument worth EUR 6 billion in grant and loan support, with payment conditioned on the Western Balkans' partners fulfilling fundamental reforms, and in particular specific socio-economic reforms. The proposed facility covers the period 2024-2027. It would provide financial support in the form of non-repayable support (up to EUR 2 billion) and loans (up to EUR 4 billion) through direct disbursements to the national budgets, or as capital investment financing through the Western Balkans Investment Framework (WBIF).

G. 2025 EU Competitive Compass

154. The Competitiveness Compass,[138] presented by the European Commission in January 2025, sets out a new roadmap aimed to restore Europe's dynamism and boost its economic growth. The Compass builds on the analysis of Mario Draghi's report of

136 Common Regional Market https://enlargement.ec.europa.eu/enlargement-policy/policy-highlights/common-regional-market_en#:~:text=The Common Regional Market action,1%25 of the region's GDP

137 In line with the Communication on "Enhancing the accession process – A credible EU perspective for the Western Balkans" COM (2020)57, the fundamentals cluster includes: chapter 23 – Judiciary and fundamental rights, chapter 24 – Justice, Freedom and Security, the economic criteria, the functioning of democratic institutions, public administration reform, chapter 5 – Public procurement, chapter 18 – Statistics and chapter 32 – Financial control.

138 See press release announcing the EU Competitive Compass https://ec.europa.eu/commission/presscorner/detail/en/ip_25_339

September 2024 on the future of European competitiveness[139] and provides a strategic framework to drive the Commission's work. Consistent with the Draghi report, the Compass seeks to address the following three so-called transformational imperatives for the EU to boost its competitiveness:

- Closing the innovation gap;
- A joint strategy for decarbonization and competitiveness; and
- Increasing security and reducing excessive dependencies

155. These transformational imperatives are complemented by action on horizontal enablers, which are necessary to underpin competitiveness across all sectors

- simplifying the regulatory environment, reducing burden and favoring speed and flexibility;
- fully exploiting benefits of scale offered by the single market by removing barriers;
- financing through a Savings and Investments Union and a refocused EU budget;
- promoting skills and quality jobs while ensuring social fairness;
- better coordinating policies at EU and national level.

156. The Compass includes a timeline and non-exhaustive list of planned initiatives for each of the three transformational imperatives as well as all horizontal enablers of which those most likely to be of particular relevance to corporate sector accounting, sustainability reporting and auditing are:

- **A new 28th legal regim**e (Q4 2025 – Q1 2026). Making it possible for innovative companies to benefit from a single, harmonized set of EU-wide rules wherever they invest and operate in the single market, instead of facing 27 distinct legal regimes, would represent a real game changer. The Commission will thus propose a 28th legal regime, which will simplify applicable rules and reduce the cost of failure, including any relevant aspects of corporate law, insolvency, labor and tax law.
- **Omnibus simplification and definition of small mid-caps** (from 26/2/2025). Regulatory burden has become a brake on Europe's competitiveness. Despite the EU's advanced better regulation policy, for two out of three companies this burden is the key obstacle to long-term investment. The Commission will deliver an unprecedented simplification effort. This will aim to achieve the agreed policy objectives in the simplest, most targeted, most effective and least burdensome way. To ensure sustained and measurable efforts over the years ahead, the Commission has set ambitious quantified targets for reducing the reporting burden: at least 25% for all companies and at least 35% for SMEs. Reporting burdens are a subset of all administrative burdens. Thus, to further increase the Commission's ambition, the 25% and 35% burden reduction targets should in the future refer to the costs of all administrative burdens, and not only reporting requirements. Dedicated measures for SMEs will aim to meet the 35% target. The first Omnibus will, among others, cover a far-reaching simplification in the fields of sustainable finance reporting, sustainability due diligence, and taxonomy. In line with the objectives of the sustainable finance framework to mobilize investment in the clean transition, the Commission will ensure better alignment of the requirements with the needs of investors, proportionate timelines, financial metrics

139 The Draghi report of September 2024 may be found on the EU website here https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en

that do not discourage investments in smaller companies in transition, and obligations proportionate to the scale of activities of different companies. It will notably address the trickle-down effect to prevent smaller companies along the supply chains from being subjected in practice to excessive reporting requests that were never intended by the legislators. To ensure proportionate regulation adapted to companies' size, a new definition of small mid-caps will soon be proposed. By creating such a new category of company, bigger than SMEs but smaller than large companies, thousands of companies in the EU will benefit from tailored regulatory simplification in the same spirit as SMEs. As promised in their January 2025 presentation of the Compass, on 26 February 2025, the Commission adopted a new package of detailed proposals to simplify rules including on sustainable finance reporting and EU Taxonomy for consideration by the European Parliament and Council.[140] Further information on the new package of proposals is presented in paragraphs 142 - 148 above.

- **Digitalization** (2025) will go hand in hand with simplification to reduce the reporting burden. Companies and public authorities must be better accompanied when it comes to implementing EU legislation through stepped up support, capacity building, and technical assistance. Use of digital tools and AI to power simplification efforts at governmental level must be facilitated, with full cross-border interoperability among public sector bodies' solutions such as e-invoicing, e-signature, e-submissions, and digital product passport. Wherever possible, reporting must move to digital formats based on standardized data. Building on the EU e-IDAS framework, the European business wallet will be the cornerstone of doing business simply and digitally in the EU, providing a seamless environment for companies to interact with all public administrations.
- **Making the most of Europe's single market** (Q2 2025). The Commission is of the view that the single market is far from complete. It believes that despite recurrent efforts to remove barriers to the free flow of goods, services, capital and people, certain barriers stubbornly persist, and new obstacles and sources of fragmentation continue to appear. Removing remaining barriers and expanding the single market will help competitiveness in all its dimensions, by providing bigger markets, lowering energy prices, and enhancing access. To improve the functioning of the single market across all industries, a horizontal single market strategy will modernize the governance framework, removing intra-EU barriers and preventing the creation of new ones, fostering collaboration with Member States, and proposing a new approach to implementation. A reinforced single market enforcement taskforce will ensure transposition that avoids unnecessary burdens, as well as overall implementation and enforcement of EU legislation. Further harmonization measures will be launched to reduce remaining legal fragmentation, in the twin interests of deepening the single market and simplification. The early and gradual integration of candidate countries into parts of the single market will allow companies to integrate in European value chains, facilitating the convergence process and enhancing investment, trade and competitiveness.
- **Standard-setting processes** (2026). The Commission will make standard-setting processes faster and more accessible, in particular for SMEs and startups. The current European standardization system lacks responsiveness to faster innovation cycles in emerging technologies. Engaging systematically in global standard setting processes is very important to influence outcomes aligned with EU interests, helping industry to

140 See EC press release at https://ec.europa.eu/commission/presscorner/detail/en/ip_25_614

maintain competitive positions in key technology markets. Alternative options must be sought to give businesses legal security on compliance with the EU rules in situations where harmonized standards do not exist, are not available, or there is an urgent need.

- **Capital markets** (Q1 2025). The EU must integrate and have deeper and more liquid capital markets as a necessary step to mobilize private sector resources and direct them towards future-oriented growth sectors. It is also necessary to stimulate greater appetite for risk-taking by private investors, using public money as an anchor. As part of this focus, the Commission will present measures to promote the EU's securitization market to create additional financing capacities for banks (which should benefit especially corporate and SME lending), and measures for much more unified supervision; it will pursue the reform and harmonization of insolvency frameworks EU-wide, currently still very fragmented, including the ranking of claims and insolvency triggers or the rules for financial collateral and settlement; and will remove taxation barriers to cross-border investment.

ANNEX

Overview of the European Union

157. A number of treaties provide the fundamental basis of the EU. The origins can be traced to the Treaty establishing the European Coal and Steel Community, also referred to as the Treaty of Paris, which came into force in 1952.[141] The 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.[142] In addition to this underlying motive, the European Coal and Steel Community rested primarily upon the ideas of economic growth, free market competition, and the improvement of living standards. The initial success achieved by Community cooperation led to successive treaties, which in turn created the institutional bodies and the body of EU laws known collectively as the acquis communautaire (EU acquis) (see paragraph 172 below). Each successive treaty (or treaty revision) and change to the EU acquis has aimed at bringing the Member States closer together economically, socially, and politically in order to promote regional stability and economic growth.

158. 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. IT then examines the **EU acquis** 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[143]

159. Following the Treaty of Paris, the Treaty of Rome entered into force on January 1, 1958, creating the European Economic Community. The Treaty of Rome laid down the framework for bringing about a common market and developing a number of common

141 For more detail on the European Coal and Steel Community, see https://european-union.europa.eu/principles-countries-history/history-eu/1945-59_en.

142 French Minister of Foreign Affairs Robert Schuman's speech on May 9, 1950. For full text, see https://european-union.europa.eu/principles-countries-history/history-eu/1945-59/schuman-declaration-may-1950_en.

143 See https://european-union.europa.eu/principles-countries-history/principles-and-values/founding-agreements_en.

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 "consultation procedure," see paragraph 186).

160. However, following completion of these initial moves towards greater community integration, by the early 1980s the process had lost momentum. Amidst mounting political criticism, the European Economic Community's political leaders decided to move forward by passing the Single European Act, which entered into force on July 1, 1987. This adapted the Treaty of Rome in order to hasten the completion of the Internal Market by December 31, 1992. It introduced a new legal basis for harmonization of laws in order to establish the Internal Market, and a new legislative procedure (the "cooperation procedure," see paragraph 187).

161. The Treaty on the European Union, also referred to as the Maastricht Treaty, entered into force on November 1, 1993, and was built on the integration successes of the Single European Act. It changed the name of the European Economic Community to "the European Community". It introduced the concept of European citizenship, enhanced the powers of the European Parliament, and launched the Economic and Monetary Union. It also introduced a new legislative procedure (the "co-decision procedure," see paragraph 188) as well as the principle of "subsidiarity" (see paragraph 176).

162. The Treaty of Amsterdam, which entered into force on May 1, 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.

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

164. The Treaty establishing a Constitution for Europe was signed in Rome on October 29, 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.

165. Subsequently on December 13, 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 included 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.[144] After some political turbulence, the Treaty of Lisbon was ratified by all 27 Member States and entered into force on December 1, 2009. A coordinated version of the Treaty on the functioning of the European Union (TFEU, the current name given to the Treaty of Rome) was published in the Official Journal of the EU on May 9, 2008.[145]

144 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

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

166. On November 22, 2023, the European Parliament adopted a new proposal[146] to amend the following Treaties: the Treaty on European Union, TFEU, and the Charter of Fundamental Rights of the European Union. The European Parliament is advocating reforms that it says will enhance the EU's capacity to act and strengthen the say of EU citizens.[147] Key among the proposals of Members of the European Parliament (MEPs) are:

- a more bicameral system and fewer deadlocks in the Council, through more decisions by qualified majority voting and the ordinary legislative procedure;
- a fully-fledged right of legislative initiative, and a co-legislator role for Parliament for the long-term budget;
- an overhaul of the rules for the Commission's composition (rebranded as the "European Executive"), including the election of its President (to be nominated by Parliament and approved by the European Council - a reversal of the current process), limiting the number of Commissioners to 15 (rotating between the Member States), enabling the Commission President to choose their College based on political preferences with geographic and demographic balance in mind, and a mechanism to censure individual Commissioners;
- significantly greater transparency in the Council by publishing EU Member State positions on legislative issues; and
- more say for citizens through an obligation for the EU to create appropriate participatory mechanisms and by giving European political parties a stronger role.

167. The report, approved with 305 votes in favor, 276 against, and 29 abstentions, was prepared by five co-rapporteurs representing a broad majority in Parliament. Parliament expects the European Council to call a Convention for the revision of the Treaties.

B. Member States, accession, and the European neighborhood policy

168. The EU currently comprises 27 Member States. In 1958, the Treaty of Rome created a common market and customs union and provided for the free move ment 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. The most recent member, Croatia, joined the EU on July 1, 2013. The United Kingdom withdrew from the EU on February 1, 2020.

169. There are eight EU candidate countries, i.e., countries in the process of transposing (or integrating) EU legislation into their national law: Turkey (since 2005), North Macedonia (also since 2005), Montenegro (since 2010), Albania (since 2014), Bosnia and Herzegovina (since 2022), Moldova (since 2022), Serbia (since 2012), and Ukraine (since 2022). Iceland was granted the status of candidate country in 2010 but withdrew from the process in 2015. There are two potential candidate countries, i.e., countries that do not yet fulfil the

146 See https://www.europarl.europa.eu/doceo/document/TA-9-2023-0427_EN.html and https://eucrim.eu/news/ep-proposed-amendments-to-eu-treaties/

147 See https://www.europarl.europa.eu/news/en/press-room/20231117IPR12217/future-of-the-eu-parliament-s-proposals-to-amend-the-treaties

Copenhagen criteria for EU membership which requires they have: stable institutions guaranteeing democracy, rule of law, human rights, and respect for and protection of minorities; a functioning market economy and the capacity to cope with competition and market forces in the EU; and the ability to take on and implement effectively the obligations of membership, including adherence to the aims of political, economic, and monetary union: Georgia (since 2022) and Kosovo (also since 2022).

170. There are several agreements that govern relations between the EU and its immediate neighbors in western Europe. Norway, Iceland, and Liechtenstein are members of the EEA, the purpose of which is to extend the EU's internal market to member states of the European Free Trade Area upon their incorporation into national legislation of EU legislation relating to the internal market. As such, EEA members have access to the EU single market, though they are not allowed to participate in the EU legislative process. Switzerland chose not to ratify the EEA agreement and is therefore the only European Free Trade Area member state that is not also a member of the EEA. However, it enjoys privileged access to the EU internal market through a number of bilateral agreements. Since the United Kingdom's withdrawal from the EU, that relationship is governed by a Trade and Cooperation Agreement that rests on four main pillars: a free trade agreement; cooperation on other economic issues; a new partnership for citizens' security; and a comprehensive governance system.

171. Going beyond western Europe, the EU has agreements with many other countries in close proximity.[148] The European Neighborhood Policy governs the EU's relations with 16 of the EU's closest Eastern and Southern neighbors. To the south: Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine,[149] Syria, and Tunisia and to the east: Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine. The objective of the European Neighborhood Policy is stabilization of the region in political, economic, and security related terms. It is complemented by regional, multilateral, and bilateral agreements and partnerships including the Eastern Partnership and the partnership with the Southern Neighborhood. The Neighborhood Policy and related instruments extend the EU's sphere of influence, including of the **EU acquis**, far beyond the confines of the EU Member States.

C. The acquis communautaire

172. The entire body of EU laws is known collectively as the **acquis communautaire**. The term is most often used in connection with candidate countries preparing to join the EU. Within the context of EU accession, a country must meet certain criteria, among which is the adoption of the EU acquis. All Member States must comply with the EU 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'.

148 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. For further information, refer to https://www.europarl.europa.eu/factsheets/en/sheet/170/the-european-neighbourhood-policy for the EU Fact Sheet on the European Neighborhood Policy as well as https://neighbourhood-enlargement.ec.europa.eu/european-neighbourhood-policy_en for the EU regulation.

149 According to the European Commission website https://neighbourhood-enlargement.ec.europa.eu/european-neighbourhood-policy_en, the designation of Palestine as a neighbor of the EU shall not be construed as recognition of a State of Palestine and is without prejudice to the individual positions of EU Member States on this issue.

For recent enlargement negotiations, the EU acquis has been divided into 35 chapters.[150] 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 EU acquis. Accession negotiations may be concluded even if the EU 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 (Company Law).

173. Agreements with countries other than EU candidate countries and EU potential candidate countries set out a different agenda for approximation to parts of the acquis although generally there are no deadlines. The EU does not offer the incentive of EU membership to these countries in exchange for aligning their legislation with the acquis however, the incentives on offer include greater integration into European programs and networks, increased assistance, and enhanced market access.

174. 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.

Main legislative instruments

175. 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 (Article 289 TFEU):[151]

- **Regulations** are addressed to, and directly applicable and binding in, all EU Member States without the need for any national implementing legislation.[152] 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 (Article 50 TFEU).

150 The 35 Chapters may be found here https://neighbourhood-enlargement.ec.europa.eu/enlargement-policy/conditions-membership/chapters-acquis_en

151 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 TFEU (OJ EU C115, 9.5.2008). See https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:C:2007:306:TOC

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

- **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."[153] As such they promote good practice throughout the EU. Soft law is often the starting point for the "Communitarization" of a particular policy area, acting as the precursor to the development of hard law.[154]

Main legislative principles

176. 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, which is the principle that government power ought to reside at the lowest feasible level i.e., at the local or regional level, instead of at the national or supranational EU level, unless the latter presents clear advantages. 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.

177. The Lisbon Treaty formally distinguishes between two kinds of measures: delegated acts (based on Article 290 TFEU) and implementing acts (based on Article 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.

178. Where uniform conditions for implementing legally binding EU 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 February 16, 2011 (EU/182/2011).[155] Implementing acts will easily be identified since the Treaty requires that the word 'implementing' be inserted in the title of these acts.

179. 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

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

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

155 Regulation EU/182/2011 of February 16, 2011, laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers.

the basic act. In such a case, the Commission shall review the draft or withdraw the draft implementing act.

D. EU institutions & the EU policy-making process

The primary EU institutions[156]

180. There are seven main institutions at the core of the EU, each playing a specific role: the European Commission (often referred to as the Commission), the European Parliament, the European Council, the Council of Ministers (sometimes referred to as the Council and legally named the Council of Ministers of the European Union), the European Court of Justice (abbreviated to ECJ and legally named the Court of Justice of the European Union), the Court of Auditors (legally named the European Court of Auditors), and the ECB.

181. The Commission is the driving force and executive body of the EU playing a central role in the European decision-making process.[157] 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."[158] The Commission is composed of Commissioners who are in charge of Directorates General, or institutionalized policy area. Each Directorate General 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.

182. In contrast to the supranational EU-level focus of the Commission, the European Council and the Council of Ministers directly represent the Member States. They consist respectively of Head of States or Government[159] 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.[160] Once the Commission issues a proposal, the Council is responsible for approving, amending or rejecting the proposal. The Member States hold the Presidency of

156 https://european-union.europa.eu/institutions-law-budget/institutions-and-bodies/types-institutions-and-bodies_en

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

158 See https://european-union.europa.eu/institutions-law-budget/institutions-and-bodies/search-all-eu-institutions-and-bodies/european-commission_en

159 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 European Council can be found at https://www.consilium.europa.eu/en/council-eu/what-is-the-council/

160 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.

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 is the Council's key committee, in which the permanent representatives of all EU Member States sit and prepare the formal Council meetings by trying to secure political agreement among the Member States.

183. MEPs are directly elected every five years and represent the citizens of the EU. There are 720 MEPs representing all 27 EU Member States. The main function of the European 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. The Parliament has various standing committees of which the Committee on Economic and Monetary Affairs[161] and the Legal Affairs Committee[162] share responsibilities on: the regulation and supervision of financial services, institutions, and markets including financial reporting, auditing, accounting rules, corporate governance, and 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 186 - 188). It is also worth noting that the Economic and Social Committee[163] (representing social groups and categories, such as employers, workers, producers, farmers, liberal professions and civil society organizations) and the Committee of the Regions[164] (representing local and regional authorities across the EU) issue opinions on legislative proposals, which are addressed to the three legislative institutions.

184. 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.

185. 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 186 to 188) 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.

The law-making process

186. 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.[165] However, Parliament's opinion is not binding on the

161 See https://www.europarl.europa.eu/committees/en/econ/home/highlights

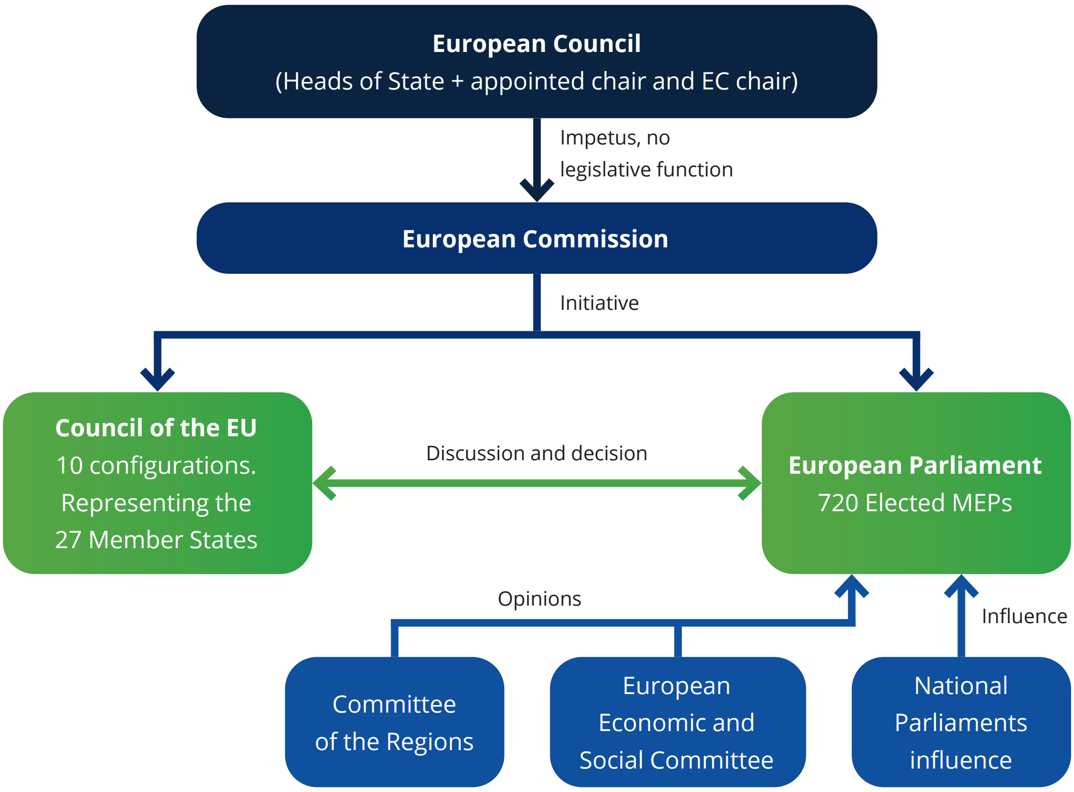
162 See https://www.europarl.europa.eu/committees/en/juri/home/highlights

163 See https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2020)659284

164 See https://cor.europa.eu/en

165 ECJ case law dictates that this does, however, give the European Parliament the power to "delay legislation" as no proposal under the consultation procedure can become final EU law, even if the Council has approved it, until EP has been consulted. There is, however, a time limit to this and EP cannot delay the proposal indefinitely by simply withholding issuing its opinion

Figure 7. EU law-making process



Source: Updated from 2015 edition of "Corporate Sector Accounting and Auditing in the Acquis Communautaire"[166]

Council. This procedure applied to the harmonization of company and accounting law until 1987. The Fourth and Seventh EU Company Law Directives on annual and consolidated accounts were adopted on the basis of this procedure.

187. The cooperation procedure was introduced by the Single European Act. 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 161); however, the Treaty of Amsterdam (see paragraph 162) reversed this by introducing the co-decision procedure. Since then, the cooperation procedure applies exclusively to the field of economic and monetary union.

188. The Treaty of Lisbon (see paragraph 165) 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.[167] 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.

166 https://cfrr.worldbank.org/sites/default/files/2019-11/EU_Acquis_3d.pdf
167 See https://www.europarl.europa.eu/infographic/legislative-procedure/index_en.html