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EUROPÄISCHE UNION DES HANDWERKS UND DER KLEIN- UND MITTELBETRIEBE
EUROPEAN ASSOCIATION OF CRAFT, SMALL AND MEDIUM-SIZED ENTERPRISES
UNIONE EUROPEA DELL' ARTIGIANATO E DELLE PICCOLE E MEDIE IMPRESE

**UEAPME's position paper on the Communication from the Commission
on a simplified business environment for companies in the areas of
company law, accounting and auditing.**

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Introduction.

On 10th July 2007 the European Commission has published its Communication “on a simplified business environment for companies in the area of company law, accounting and auditing”.

This Communication is part of the better regulation and simplification agenda of the European Commission, which is of utmost importance for SMEs and their competitiveness.

UEAPME welcomes every initiative that reduces the administrative burden for SMEs and/or that could make legislation simpler.

Nevertheless, UEAPME has its doubts about the content of the proposals made in the Communication and about the preparation of this document. It also regrets once again the too short consultation time.

In the field of simplification and better regulation every level, the European and the national level has to take its responsibility. We have the impression that the Commission, under pressure to deliver, has opted for the simplest ways, to pass the problems to the Member States, knowing that not every member state will be able, for just reasons as explained in this position paper, to deliver.

The introduction mentions that the Commission has started to measure the administrative burdens in company law and accounting throughout the European Union. The paper states that “this measurement is currently carried out with the help of external consultants”. UEAPME wonders why this measurement is carried out if the actual proposal doesn't take into account the results of it. In addition, according to the paper “the exercise will support work towards a well regulated Europe, which involves a critical assessment of how existing laws can be improved and administrative burdens can be reduced”. UEAPME has to note that to date no assessment has been carried out in this field. UEAPME has always warned for a simplification of the better regulation and simplification issue. It is not good governance to do proposals without a minimum assessment of all the benefits, associated costs of rules and to look again behind the objectives and aims of the rules one will change.

It is also shocking that the Commission in its communication mentions that “*in the follow-up to this communication and on the basis of the responses received, the Commission will*

prepare full and comprehensive impact assessments that will also take into account the results of the measurement of administrative costs currently underway.”

Impact assessments have to be carried out before any proposal. Indeed, they should be the basis for any proposal in order to be able to evaluate and assess the different options and solutions. Impact assessments have in addition nothing to do with the opinion of the different stakeholders, as real impact assessments have to give a neutral and objective scientific input concerning the consequences of the different possible proposals.

In this position paper UEAPME will further on only comment on point 4 of the Communication which deals with “**Simplifying Business for SMEs in the area of accounting and auditing**” and has a very high impact on SMEs.

Content of the Commissions proposal.

The Commission proposes to exempt "micro entities" from the application of the accounting directives as “*for these smallest enterprises the burden related to the establishment of the annual accounts is particularly heavy. At the same time there is a lack of broad demand for their financial statements*”. With an exemption in the accounting directives, it would be left to Member States to determine which rules micro entities should be required to comply with. Stakeholders are therefore invited to give their views on whether they agree with an **exemption of micro entities** from the scope of the Fourth Directive and on the following possible definition for these micro entities:

- less than ten employees,
- balance sheet total below 500,000 EUR, and
- turnover below 1,000,000 EUR.

In addition, the following simplification measures in favour of SMEs are proposed:

- To **extend the transition period for SME's** crossing the thresholds from two to five years. Companies in the start-up phase will particularly benefit from a longer transitory period before more detailed accounts have to be prepared;
- To **exempt small entities** from the requirement to **publish** their accounts;
- To make it possible for certain medium-sized entities to use exemptions currently available only for small entities. This measure would in particular concern companies where the structure of members is such that there are no particular external user needs and unlimited liability companies.

UEAPMEs position.

It has to be remembered that the Commission - DG Internal Market - issued a discussion paper in December 2006 on the simplification of accounting rules for SMEs. UEAPME has participated in this consultation by drafting a position paper with comments and observations. All the comments and observations made in that position paper are still valid and relevant. That’s why we add it again “in extensu” to this position paper. ⁱ

UEAPME regrets that apparently none of its comments have been taken into account, that there is no reference in the Communication to the results of the consultation and that no feedback has been received from the Commissions services.

1. Exemption of micro-entities from the application of the accounting directives and auditing.

The first problem is the definition of “micro-enterprises”. There is already a definition of them in the 2003 Recommendation, but in the Communication the Commission itself states, that:

“The threshold defined in the recommendation for SMEs are much higher than those in the Fourth Directive, and a full use of these exemptions could therefore nearly lead to a repeal of this Directive for small companies. This result does not seem desirable as harmonized accounting requirements are needed for cross-border investments and company operations also for small companies.”

Therefore the Commission proposes to lower the thresholds. (Less than 10 employees, balance sheet total below 500.000 EUR and turnover below 1.000.000 EUR.)

Comments:

The Communication fails to give any quantitative impact of the proposal. Data received from our member organizations reveal that for example in Belgium this would mean that 75% of all small companies could be exempted¹. We suppose that this will also be the average percentage for the whole of the European Union². The impact on SMEs will be indeed very high.

It may be clear that the application of the new threshold would in fact **lead to repeal the Directive for small enterprises.**

If the Commission wants to avoid this “negative” effect, then it will be necessary to lower the thresholds even more drastically.

The proposal of the Commission is also an attempt to lower **the administrative burdens** for SMEs. One can question if this will really be the case.

Indeed, enterprises, also small and micro-enterprises will continue to need financial information for example in order to have access to finance, towards suppliers, clients, to get information about potential business relationships, competitors and so on. Also in the case of transfer of a company, an exact and correct overview of the financial situation of a company is key.

In addition, the legal obligation to keep financial reports is also connected, in a lot of member states, with an obligation to file a tax return, based on those financial reports.

There are also indications that without accounting the cost for access to finance, taken into account the Basel II requirements will increase.

In a significant number of SME entities the owner(s) is/are also responsible for the management and leadership of the entity. For such companies the need for financial reporting is particularly driven by the need to evaluate the position of the company to enable the development of the future strategy, rather than the need to report to a wide range of users on

¹ Data Nationale Bank van België/Banque Nationale de Belgique

² For France 80% of all so-called craft enterprises – data APCM

historical performance. So financial reporting has a function also for micro-entities and can help to avoid bankruptcy.

Due to the fact that the Member States will have the possibility to except micro-entities and not the obligation, there is also the risk that there will be a competitive disadvantage for the companies in those countries were the Member states didn't exempt. This consequence goes against the position of the Commission expressed in the Communication that "*Company law and accounting are central elements to achieve the common market... and that harmonization has also positive effects on the competitiveness of companies.*"

At macro-economic level the data are used to calculate the BNP (which are used to calculate the funding of the EU). When, as a consequence of the exemption of the majority of the companies, this information will not be available anymore, then it will be necessary to collect this information through other measures as for example surveys, which will lead to higher administrative costs (this system already exist in the Netherlands).

The Commission neglected to explain what the consequences could be for one of its own offices, EUROSTAT, when it will not be possible any more to calculate as precise as before the BNP of the member states.

2. Relieve from publication requirements for small enterprises.

According to the Commission the publication requirements for small companies create major administrative burdens. The Commission therefore suggests abolishing these requirements for this category.

Here there are quite different rules in the Member States. Nevertheless, once you have the accounts, it is not that burdensome to apply the publication requirements. (Although SME complain about the high cost for the publication itself, which is a national competence). Here it has to be mentioned that, at the moment, the different rules in the member states lead to competitive disadvantages for enterprises in countries with strict requirements. There is a clear need for harmonisation in this field. If this harmonisation should lead to the relieve from publication requirements, is another question. So here we need an in-depth discussion about which kind of information should be published or not (based on a preliminary in-depth study about the needs of SMEs and the needs of users, as requested by UEAPME already in February 2007).

The publication requirements are also the counterpart of the limited personal liability. Small business owners have a choice to trade under an incorporated entity or unincorporated entity, with the later associated with significantly reduced levels of transparency and reporting.

If a small business owner-manager chooses to opt for an incorporated entity, with considerably more acquired protection of limited personal liability vis-à-vis their business debts, it is not unreasonable for them to expect to be required by law to disclose certain financial information in the interests of those trading or investing in their entity.

3. Extension of the transition period for SME's

UEAPME agrees with the Commission proposal for the time being under the actual legislation in force. If micro-enterprises would be excluded, our position has to be reviewed.

4. Conclusion.

It is important that the principle guiding the discussion does not focus only on 'simplification' but also on the 'relevance' to SMEs of financial reporting needs vis-à-vis large listed companies. The issues associated with simplification tend to focus on costs whilst issues focused on relevance are concerned with the benefits of financial reporting and in particular users and their needs.

With this proposal the Commission is mixing up accounting with administrative burdens, while neglecting the important role of accounting as a management and communication tool.

UEAPME urges the Commission to submit every proposal to change the 4th Directive at a **serious, very detailed impact assessment, especially targeting the small and micro enterprises.**

In addition, UEAPME repeats its request **to launch a study and to do the necessary research to determine the needs of the SMEs and the needs of users, which may vary across EU member states.** We therefore recommend that research in this area be undertaken in order to provide foundation for sensible policy proposals in the future.

In addition UEAPME recalls its demand to investigate how the options already given to Member States are working prior to introducing new Directives. Prior to changes in financial reporting requirements of SMEs, the current position in terms of uptake of the options under the 4th and 7th Directive should be considered. This investigation should include (a) use of options, (b) motives cited by member states in introducing options and (c) a review of member states' success in meeting their objectives.

An important reduction of red tape from SMEs would be the reduction of the number of times that a company has to give the same information to different (or even the same) administrations (the so called "only-once principle"). There for UEAPME requests the Commission to publish a recommendation urging the member states to apply the only-once principle wherever possible.

Also a reduction of the number of annexes to the financial statements should be considered.

Brussels, October 2007.

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ⁱ **Comments and observations on the Discussion Paper of DG Internal Market on the simplification of accounting rules for small and medium-sized companies.**

The following sets out UEAPME's comments and observations on the 'Discussion of possible amendments to the Fourth and Seventh Company Law Directives':

1. The initiation of a discussion on the meaningful reduction in regulatory burden on SMEs under the 4th and 7th Company Law Directive is timely and appropriate if SMEs are to prosper in the European single market. The problem of regulatory burdens on SMEs is invariably caused by the original regulations being designed for large business entities. Such regulations are not necessarily relevant to SMEs and often create a significant administrative cost burden.

Simplification based on the needs of SMEs and users of financial information

2. It is important that the principle guiding this discussion does not focus only on 'simplification' but also on the 'relevance' to SMEs of financial reporting needs vis-à-vis large listed companies. The issues associated with simplification tend to focus on costs whilst issues focused on relevance are concerned with the benefits of financial reporting and in particular users and their needs.
3. One of the problems of the Accounting Directives and the requirements for incorporated companies in the EU is that, in a significant number of SME entities the owner(s) is/are also responsible for the management and leadership of the entity. For such companies the need for financial reporting is particularly driven by the need to evaluate the position of the company to enable the development of the future strategy, rather than the need to report to a wide range of users on historical performance. In some member states, e.g. Belgium, the legal obligation to keep financial reports is also connected with an obligation to file a tax return, based on those financial reports. This often confuses discussions regarding the requirements of financial reporting over the range of SMEs who are subject to the Directives.
4. The Discussion Paper states that "*the Accounting Directive must take as its starting point the actual needs of SMEs and the users of their accounts*". If financial reports are to be useful and relevant, investigating users and their needs is critical in the development of a European financial reporting framework for SMEs.
It is also important to remember that SMEs themselves are an important user of financial information, e.g. as suppliers and contracting parties to other SMEs, when assessing credit-worthiness is important.
5. To date there has been a lack of research and supporting evidence to determine the needs of users, which may vary across EU member states. We therefore recommend that research in this area be undertaken in order to provide foundation for sensible policy proposals in the future.
6. In the context of the 'simplification' of accounting rules for SMEs, it is important that rigorous impact assessments are carried out, including the assessment of the benefits of financial reporting as well as cost/administrative burdens. This should include consideration of why financial reporting requirements were initially imposed and the interests, in terms of stakeholders, that they protect.

Harmonisation to create a level playing field in the EU

7. Cross border trading by SMEs is growing between member states within the EU. There is a strong case, therefore, for developing the harmonisation of financial reporting frameworks and rules to (a) support this growth in trade and (b) create a level playing field. This may require fewer options and a move to maximised harmonisation, e.g. in the field of publication of financial information and public access to such information.
8. The modernisation and harmonisation of financial reporting requirements, where possible, has to be encouraged. There are, however, recognised fiscal and cultural differences between EU member states, such as, for instance, the use of fair value accounting, that need to be taken into account. Such

differences may be reflected in national financial reporting requirements in so far they do not jeopardize trade between member states or the creation of a level playing field between SMEs from different member states.

Simplification of the Directives

9. Paragraph 6 of the Discussion Paper refers to “*Ways of Achieving Simplification for SMEs in the Accounting Directives*” which in the main are extensions of the current options for SMEs under the Directives.
10. It is important to investigate how the options already given to Member States are working prior to introducing new Directives. Prior to changes in financial reporting requirements of SMEs, the current position in terms of uptake of the options under the 4th and 7th Directive should be considered. This investigation should include (a) use of options, (b) motives cited by member states in introducing options and (c) a review of member states’ success in meeting their objectives.
11. The outcomes of the IASB’s SME project, even if they are not appropriate for mandatory implementation in the EU, may provide useful insights which can inform discussion on simplification of the Directives.
12. As mentioned above, a major problem with the current situation is a top down approach, which (a) results in administrative burdens on SMEs, and (b) reduces the relevance of financial accounting frameworks and standards for these entities (observation 1). A future review of financial reporting in the EU should re-address this problem by taking a bottom up approach. Such an approach would concentrate on the needs of SMEs, and would be informed by research into users and their needs as proposed above.

Brussels, February 2007.