

Financial reporting: Commission proposes to update accounting rules for the 21st century

The European Commission has presented a proposal for a Directive amending the existing European Union Accounting Directives. The proposal brings existing EU rules into line with current best practice. It complements the International Accounting Standards (IAS) Regulation, due for final adoption by the Council in the next few days, that requires all EU companies listed on a regulated market to use IAS from 2005 onwards and allows Member States to extend this requirement to all companies (see [IP/02/417](#) and [IP/02/200](#)). The amendments now proposed to the Accounting Directives would allow Member States which do not apply IAS to all companies to move towards similar, high quality financial reporting. They would allow appropriate accounting for special purpose vehicles, improve the disclosure of risks and uncertainties and increase the consistency of audit reports across the EU. The proposal is an important element in the Financial Services Action Plan (see [IP/00/1269](#)), endorsed by the Lisbon European Council as a key element of the creation of an integrated financial services market. It is also in line with the strategy outlined in the Commission's June 2000 Communication on the future of financial reporting in Europe (see [IP/00/606](#)).

Internal Market Commissioner Frits Bolkestein said, "This proposal demonstrates again our commitment to transparent, high quality financial reporting, consistently applied across Europe. Shareholders, potential investors and the public need to know from companies' accounts exactly how well they are performing and to be able to compare like with like. An efficient internal market demands no less. The amendments to the Accounting Directives complement the policy of moving towards International Accounting Standards. This proposal has been in preparation since 1999, but the collapse of Enron serves to underline its importance even more strongly."

The proposed IAS Regulation will require all EU companies listed on a regulated market to prepare their consolidated accounts in accordance with endorsed IAS from 2005 onwards. Member States may extend this requirement to unlisted companies and to annual accounts. Where endorsed IAS is not applied, the detailed provisions of the 4th and 7th Accounting Directives, which this proposal would amend, will continue to act as the basis of EU accounting requirements. These Directives may therefore continue to be applicable to up to 5 million companies in Europe.

The Commission's proposal would bring EU accounting requirements into line with modern accounting theory and practice. In doing so, it would remove all inconsistencies with International Accounting Standards (IAS). Notably, it makes it more difficult for a company to 'hide' liabilities by setting up artificial structures (so-called 'special purpose vehicles') which, in substance, they control but which, considering only the shareholdings, appear to be largely unrelated. This is an important step in the proper treatment of off-balance-sheet financing.

Given the link, in some Member States, between annual accounts and taxation, it is important that each Member State move toward IAS at a pace appropriate to that individual country. Accordingly, most changes are implemented as Member State options – allowing gradual alignment of national accounting requirements with IAS.

As well as modernising accounting requirements, the proposed amendments make clear that, in the annual report, the analysis of risks and uncertainties facing the company should not be restricted to financial aspects of its business. This is in order to encourage disclosure of key social and environmental aspects where relevant.

The proposed amendments also move towards a more harmonised presentation of statutory audit reports, by outlining the necessary content of such reports, which are a valuable assurance that accounts are reliable. The new requirements are consistent with those of International Standards on Auditing issued by the International Auditing and Assurance Standards Board.