



26 January 2010

**JOINT POSITION PAPER:  
EXEMPTING MICRO-ENTITIES FROM THE FOURTH COMPANY LAW DIRECTIVE  
(ACCOUNTING AND AUDITING)**

***Entirely in line with the Think Small First principle and the Commission's target to reduce administrative burdens on EU businesses by 25% by 2012, the Commission's proposal to exempt micro-entities from EU accounting Directives, with a savings potential of €6.3 billion per annum, is a clear and tangible measure to help SMEs. Particularly in light of the current economic climate, indecisive behaviour by policy makers cannot be justified. We urge the Parliament to respect the EU's commitment to reduce administrative burdens by 25% by 2012 and proceed to speedy adoption of the Commission's proposal to exempt micro-entities from the scope of the 4th Accounting Directive.***

#### Background

The proposed Directive is in line with the EU's Better Regulation policy<sup>1</sup> which aims at simplifying and generally improving the regulatory environment by cutting red tape, improving the quality of regulation and design better laws for consumers and businesses alike.

In 2007, the Commission identified 42 pieces of legislation in 13 priority areas which represent an estimated €115 -130 billion of administrative costs.<sup>2</sup> On this basis, it has put in place an Action Programme<sup>3</sup> to reduce administrative burdens on businesses in the EU by 25% by 2012. The target was endorsed by the European Council in March 2007.<sup>4</sup>

Based on the Commission's Communication<sup>5</sup> on a simplified business environment for companies in the area of company law, accounting and auditing, a report<sup>6</sup> from the High Level Group of Independent Stakeholders on Administrative Burdens (HLG) called for

rapid enactment of a Member State option to exempt micro-entities from the 4th Company Law Directive with *Think Small First*<sup>7</sup> as guiding principle.

In addition, the European Economic Recovery Plan<sup>8</sup> called on the EU and Member States to take urgent steps to substantially reduce administrative burdens for SMEs and micro-enterprises, in particular by fast-tracking the corresponding Commission's proposals and by „removing the requirement on micro-enterprises to prepare annual accounts“.<sup>9</sup>

Moreover, the European Parliament called on the European Commission to come forward with a legislative proposal that allows Member States to exempt micro-entities from the scope of the Accounting Directives.<sup>10</sup> On 26 February 2009, the European Commission tabled a

<sup>1</sup> COM(2002) 278 final

<sup>2</sup> COM(2009) 15 final

<sup>3</sup> COM(2007) 23 final

<sup>4</sup> Presidency conclusions of the European Council (7/8 March 2007), p.10

<sup>5</sup> COM(2007) 394

<sup>6</sup> Opinion of the HLG on administrative burden reduction in the priority area of company law (10 July 2008), p. 6

<sup>7</sup> The definition of the "Think Small First" principle implies that policy makers give full consideration to SMEs at the early policy development stage. Ideally, rules impacting on business should be created from the SMEs point of view.

<sup>8</sup> COM(2008) 800 final

<sup>9</sup> *ibid*

<sup>10</sup> European Parliament's resolution of 18 December 2008 on accounting requirements as regards small and medium-sized companies, particularly micro-entities, P6\_TA(2008)0635

proposal<sup>11</sup> amending Directive 78/660/EEC on the annual accounts of certain types of companies.

### **Objective**

The proposed Directive would enable Member States to exclude micro-enterprises from the scope of the 4th Company Law Directive and thus exempt them from certain burdensome accounting requirements. The overall cost reduction amounts to estimated savings of €1,200 per micro-company per annum. EU-wide, this would amount to annual savings of €6.3 billion.<sup>12</sup>

### **Contents**

The Commission proposal aims at a significant simplification of the business environment and the financial reporting requirements for micro businesses in particular. It sets out to enhance both competitiveness and growth potential of micro-entities. To define what constitutes a micro-entity, the Commission sets out three main criteria. For this proposal, the company should have to meet two of the three following criteria:

- a. Less than 10 employees average during the financial year;
- b. A balance sheet total below €500.000;
- c. A net turnover below €1.000.000

For these companies, the Commission's objectives are to reduce administrative burden while safeguarding adequate protection and information to stakeholders, and to align the reporting requirements of micro-entities to the real needs of users and preparers of the accounts.

### **Why should micro-entities be exempted?**

The exemption is completely in line with the European Commission's target to reduce administrative burdens on business by 25% by 2012 and the principles set out in the Small Business Act for Europe (SBA). At the heart of the SBA is the objective to achieve the best possible framework conditions for SMEs based on the application of the 'Think Small First' principle. When the Accounting Directives were created, SMEs were not seen as essentially different from large companies. Yet, SMEs can be affected by the cost of regulations more than

larger companies.<sup>13</sup> Currently, the EU has come to the acknowledgement that small businesses have specific needs. Micro-entities are fundamentally different from medium sized companies. The specific nature of micro-entities requires exemption from rules that are designed to fit large companies. The exemption will enable Member States to align micro-entities' reporting requirements with the real needs of users and preparers of financial statements. Start-up enterprises and micro-entities with limited resources are sensitive to unnecessary administrative obligations. Taking into account that a considerable part of the administrative costs is fixed, the burden on micro-entities is disproportionately large in comparison to larger companies. It is essential that micro-entities focus their energy on the core of their business instead of unjustified burdens, enabling them to boost their competitiveness and increase their growth potential.

### **Unjustified objections**

Since the publication of the Commission's proposal, certain stakeholders have been questioning the value of the exemption. None of the objections asserted by these parties seem to be justifiable.

### ***'The exemption will be harmful to the Internal Market'***

93% of all micro-entities in Europe do not engage in cross-border activities, harmonized (annual) accounts for this group are therefore not necessary. The voluntary nature of the exemption leaves the remaining 7% the freedom to draw up these accounts if their trading partners would require them to do so. The exemption would not cause a distortion in competition since micro-entities, operating mainly on a local level, do not form any competition to their counterparts in other Member States. Furthermore, rapporteur of the Legal Affairs Committee (responsible) in Parliament, Klaus-Heiner Lehne, has drafted a compromise amendment which would exclude micro-entities that acquire more than 10% of their total income from cross-border activities from the exemption. *We are in full support of this reasonable and fair amendment.*

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<sup>11</sup> COM(200) 83 final

<sup>12</sup> SEC(2009) 2071

***'Micro-entities will need the annual accounts to obtain bank loans'***

In response to a consultation in 2007, banks were generally in favour of exempting micro-entities from the requirements of the Accounting Directives. In order to supply loans, banks request information that deviates from the data presented in the annual accounts. Annual accounts are often disclosed months after the closing of the previous financial year and therefore do not necessarily represent a company's current financial situation. If a bank requires specific financial disclosure, the micro-entity will always have the option to provide this information.

***'Micro entities will need to disclose their annual accounts to clients and shareholders'***

The majority of micro-entities are run by their owners; there is no need to protect external shareholders. Furthermore, micro-entities do not acquire their funds from the capital market but from their local banks. In cases where micro enterprises do have investors, these are often directly involved in the company's operations and have access to its accounts. Moreover, relationships in these small companies are often based on mutual trust rather than financial disclosure. The nature of business of the majority of micro-entities is not of the sort that would require financial disclosure to clients. This again underlines the importance of aligning the micro-entities' reporting requirements with the *real* needs of users and preparers. If business requires a micro-entity to disclose financial information, it may always choose to do so. Furthermore, the exemption does not free micro-entities from filing tax returns. Financial partners can make use of these tax returns to acquire the necessary financial information about the company. In the (relatively few) cases where a micro-entity has partners, the requirement to present annual accounts for approval by the partners will be

based on *commercial law* and will therefore not be affected by the exemption.

***'Reducing administrative burden for SMEs must be realized in a coherent and comprehensive manner, why not wait for a complete revision of the Accounting Directives?'***

As argued earlier in this paper, micro-entities fundamentally differ from medium sized companies. The specific nature of these small companies requires an exemption from rules that are designed to fit companies with up to 250 staff. Moreover, a complete revision of the Accounting Directives is not likely to take place before 2011 and will in itself take years to actually become effective. There is no guarantee as to the results of the revision and the implications for micro-entities. Based on the 'fast track procedure' (as advised by the High Level Group on the Reduction of Administrative Burden), the proposal for exemption, reducing admin burden considerably, calls for speedy adoption by Council and Parliament.

**Conclusion**

We are aware that a small percentage of micro-entities will need to continue to draw up annual accounts. However, to the great majority of micro businesses in the EU, operating almost exclusively at local level, the exemption will mean a tangible and real reduction of unnecessary and unjustified administrative burden. Therefore, we urge Council and Parliament to respect the EU's commitment to reduce administrative burden by 25% by 2012 and proceed to speedy adoption of the Commission's proposal to exempt micro-entities from the scope of the Accounting Directives.