Appendix 1: Greater convergence of financial reporting rules – who and why?

1.1 The Single Accounting Directive is part of a steady effort to harmonise financial statements within the European Union

- The European Union has pursued the goals of organising and harmonising financial information in Europe over the past forty years, following on from the accounting directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies.
- The Single Accounting Directive 2013/34/EU of 26 June 2013 is the successor to these development efforts. It sets out common principles for annual financial statements and consolidated financial statements, which had previously been governed by two different accounting directives that this new directive replaced. The Single Accounting Directive also aims to simplify accounting requirements for small and medium-sized companies and make it easier to compare financial statements across the entire European Union by reducing the number of options available to Member States as compared to the two previous directives.
- It has a general application in terms of both its scope, which covers all European companies (on condition that obligations are proportional to their size), and its consideration of the users of financial statements. From a legal standpoint, it plays a key role in the reporting of financial statements, combining with the two related accounting directives on the insurance and banking sectors to form a comprehensive corpus.
- The French accounting standards authority, *Autorité des normes comptables* (ANC), therefore notes the fundamental importance of the Single Accounting Directive for the European Union and its efforts to ensure accounting harmonisation and the development of the European public good on accounting issues.

1.2 It is perfectly commendable to look into the potential future changes in the accounting directive, but these efforts must serve to strengthen its substantial existing contribution. Before pursuing greater harmonisation, it is vital to first conduct an objective review of the Member States' use of the options currently included in the directive and set strategic targets. Difficulties in staging cross-border business are not an appropriate justification for overhauling the system.

<u>European Union (EU) is an easily accessible area for trade</u>

- The EU is broadly easily accessible to both European and third-country companies as compared to other areas of the world, assuming that they comply with certain conditions e.g. they must have a permanent establishment.
- The European Union applies harmonised rules across the single market to promote trade among Member States, while safeguarding the specific features of each State and the subsidiarity principle.

- From an accounting standpoint, the Single Accounting Directive sets out a shared financial reporting framework for all European companies, laying out the key principles and providing financial statement models. It dovetails with the two accounting directives on the insurance and banking sectors to provide a consistent corpus for the EU, while taking on board the specific features of the financial and non-financial sectors.
- The aim of a review of this unified accounting framework may be to develop cross-border business for European companies within this market, but it must be proven that reporting differences actually act as a hindrance, which is far from given.

<u>The main determining factor in a company's ability to conduct cross-border trade is the existence or not of an accessible market in the other State</u>

- The ability to develop cross-border economic activity within the single market hinges firstly on the existence of a market (its size and momentum, how open it is, the related risks and access conditions) and secondly on the ability to handle language and organisational differences on local markets i.e. administrative, tax, specific features of prospective clients.

<u>Against this backdrop, the various national reporting rules are a technical difficulty that should be set into context, rather than a real obstacle to conducting cross-border business</u>

- National differences in reporting rules are therefore secondary considerations in this respect, creating technical difficulties that are in no way an obstacle to developing business. They add further complexity and cost, particularly for translation, but these aspects should be set into context as these differences are not an impossible obstacle or a true hindrance to successfully conducting cross-border business.
- Differences in national regulations, particularly in terms of reporting, are costlier to manage for small companies than for larger businesses, so it is important to take on board this size aspect, which is what the accounting directive already endeavours to do.
- The costs generated by these differences are manageable overall. Certain areas can be simplified, especially for smaller companies, which suffer higher costs in relative terms, but there is no need to change the accounting standard as a whole just for this reason.
- It is obviously still useful to consider whether the convergence achieved by the accounting directive is appropriate, but this issue must be viewed in light of other criteria than the feasibility of conducting cross-border business, which is not particularly useful.

1.3 *It is vital to carry out a review of Member States' use of the options available in directive 2013/34 before seeking greater accounting harmonisation*

- Directive 2013/34, or the Single Accounting Directive, already provides a shared base of rules, some of which include options, although there are fewer options as compared with the directives that the Single Accounting Directive replaced. Before any fresh changes are made, it would be useful for the Commission to carry out a review with Member States of their use of the options provided for by the directive to help assess the extent of divergences and the potential ways to reduce them. Increased convergence does not necessarily require a decrease in the number of options, but rather a more detailed framework for the way they are applied.
- A small number of the current options involve significant issues. The directive lays out the general principle for the valuation method based on historical cost, while alternative valuation methods such as fair value and revaluation provide Member States with extensive flexibility in applying the directive to the detriment of the harmonisation sought. Conditions for application should therefore be more clearly defined Europe-wide in order to bolster the general principle. It is useful to identify the number of options used, but it is also key to assess how they are applied: this process does not seek to undermine the existence of these options, but rather it could be helpful in better regulating the ways they are applied across Europe by reducing their scope and making them more consistent with the directive's general principles. It is worth noting that the fair value option outlined in the directive enables users to apply fair value accounting more extensively than international standards, thereby creating greater complexity and volatility, running contrary to the needs of unlisted companies.

1.4 Which companies need stronger reporting rules?

<u>Specific uniform rules for companies with cross-border business are not necessary</u>

- A specific accounting framework for companies with cross-border business is unnecessary: this type of set-up would mean that a company that endeavours and fails to expand its operations internationally would have to change its accounting rules just for this reason.
- Another point worth noting is that cross-border business usually involves a very specific group of large companies, while small and medium-sized companies are usually local and their business operates on a domestic scale. Applying a different set of accounting standards as soon as these smaller companies embark on international business could well create an additional curb on their business from the outset.
- The most important aspect for smaller entities is the relatively high cost of the requirement to take on board a new set of accounting standards, as compared with their size.

Application of uniform rules for companies proportionate to their size must be maintained

- It is vital to maintain a single set of accounting principles for statutory accounts to ensure easier comparison of companies and in the interests of the common European good: all companies apply the same standards and can simplify depending on their size.
- The issue of increased convergence within the EU should be addressed differently depending on the companies in question.
- It is important to identify European companies that apply IFRS and achieve accounting harmonisation, thus meeting the markets' financial information requirements on the one hand, and other companies that do not need such extensive European harmonisation on the other.

Appendix 2: The accounting directive is an essential starting point for single financial reporting for all users

2.1 Different uses and different users of financial statements

- Statutory accounts can be used for a number of different purposes: they are used as the basis for legal conditions on companies' payout; they provide the foundations for tax law, regardless of the extent of reconciliation between financial statements and tax reports, and regardless of the size of companies; they are used to provide employee information and as a management performance metric; lastly, for companies that are not subject to IFRS, these accounts are additionally used as information for third parties i.e. local lenders such as banks and factoring companies.
- Statutory accounts provide the common denominator for these various different uses.
- Meanwhile unlisted companies in France can decide between two sets of standards when filing their consolidated accounts – French consolidation rules or IFRS as endorsed by the European Union. The French standards allow for a less complex, less legal and more business-oriented presentation, which is particularly useful for banks and companies' main creditors. Once again, it is important to develop accounting standards that take on board users' requirements in this respect.

2.2 Reiterate accounting rules as the foundations for consistent financial reporting, suited to the requirements of its various users

- It is vital that European financial reporting rules play a role in strengthening the intra-European market as regards a range of other related issues i.e. promotion of tax cohesion within the European Union, consideration of needs of all users of financial statements, aim of avoiding excessive reporting requirements for companies.
- In the accounting directive context, users are not just investors and lenders, as accounts models in particular also include information for staff, the Directorate General for Enterprise, public administrations and creditors.
- The current framework is appropriate and should not be extended. The EU accounting framework is part of a broader European set-up that covers all aspects of corporate reporting obligations; financial statements, the corporate governance report and the management report cover a very wide scope and provide information on a company's or group's strategy and business model.

- It is important to correctly define financial information to ensure that legal rules on dividend pay-out and tax rules on company income are properly applied. The common consolidated corporate tax base (CCCTB) initiative currently being discussed requires great attention to the way the existing accounting directive and these future EU regulations fit together. Tax and accounting standards must be taken forward at the same time, as both are important in assessing economic performances.
- On a similar note, accounting standards should provide for performance indicators if they are to be used for the purposes of these standards. Yet Council directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the interternal market (currently undergoing implementation into national legislation) sets up a system for restricting tax deduction of interest expense based on a percentage of companies' EBITDA. This directive provides a definition for EBITDA solely for the purposes of this regulation, but this reflects the need to consider the role of EU-wide accounting standards in defining these indicators used for the purposes of these standards. This does not mean trying to define all alternative management indicators, as they would then become useless as a way of reflecting the specific features of each company, unless each company explains the indicator's components and ensures that it remains constant.

2.3 Application of pan-European accounting rules for groups (IFRS, IFRS for SMEs, etc.) would mean running the risk of creating a multi-speed European Union

- The introduction of an additional pan-European set of standards for groups raises the risk of hampering harmonisation goals and failing to take on board European interests, particularly as the European Union would not be in charge of maintaining and developing these standards.
- Implementation of a pan-European standard, which would be optional for unlisted groups, will not help simplify their business operations across the EU as companies would still have to file financial statements for tax purposes and dividend payout calculations in each State, which would not help make the situation any more straightforward.
- This would raise difficulties on both harmonisation and comparison between companies, so two companies in the same Member State would have different situations, depending on whether they are part of a group or not.
- In light of these various issues, implementation of a pan-European set of standards must be considered with great caution.

Appendix 3: Relationship between common accounting and tax rules in the European Union

As an introductory remark, it looks premature to consider the potential accounting consequences of implementation of the common consolidated corporate tax base, given that negotiations on the proposed directive are currently under way.

3.1 Accounting must act as the linchpin for financial reporting and a benchmark for tax and legal matters for payout purposes, rather than the opposite.

- Accounting is a way of assessing economic performances and aims to measure and provide information on an entity's business results. Tax liable as a result of a company's business performances must therefore be based on accounting figures, and the reverse approach would not be coherent. Similarly, economic performances also provide the basis for paying out dividends.
- It is worth discussing the ways to harmonise performance measurement, and it is not coherent to use different company performance measurement systems for dividend purposes, tax and economic performances. Tax obviously serves to meet economic and fiscal policy goals, which should be clearly distinguished from accounting, but these differences must be limited and based on economic reality to ensure that they remain relevant.

3.2 Tax-accounting convergence should be promoted as it simplifies matters for companies, which then only have one set of standards to manage and declare, and also for authorities, helping creating a coherent environment.

- Accounting is the best way to portray companies' economic transactions and should naturally act as the starting point for any related regulation, whether tax or legal, so a strong relationship between regulation and accounting is the ideal situation for Europe and a target to be pursued.
- A decision to establish a clear relationship between accounting and tax, as is the case in France, requires the production of statutory accounts using the same accounting standards for all companies. If there is to be a clear correspondence between tax and accounting, as ANC supports, this firstly requires the development of common accounting rather than tax rules.
- In light of these various factors, tax and accounting standards should be developed at the same time, and the European Union must ensure that progress is made simultaneously on these two aspects.

Appendix 4: Promote European accounting principles for annual accounts and consolidated accounts for unlisted companies

- The Single Accounting Directive includes general principles with varying degrees of assertion and expressly defined i.e. prudence, true and fair view. Adding a conceptual framework to this directive would not provide any additional advantages and would actually raise a number of questions on how the conceptual framework and the directive fit together.
- The accounting directive's general principles must also be highlighted and reiterated both when developing local standards in the different Member States as well as endorsing international standards.
- Moves to enhance, specify and develop the scope of these principles would help strengthen the European Union's role in accounting discussions and in the future act to promote increased harmonisation in the area.
- Similarly, this European accounting framework must change and evolve to take on board changes in companies' environments where necessary. It is essential that the accounting framework be suited to the requirements of the various stakeholders, enabling them to deal with new transactions.
- However, moves to deepen the European accounting framework first require an extensive review of potential differences between the Member States and a clear strategic goal, outlined in cooperation with all stakeholders.

Appendix 5: How the EU delegates and monitors development of accounting standards

5.1 The European Union is the most involved area in global international accounting standards

- The EU gave a clear signal of its emphasis on global accounting standards when it opted to delegate development of accounting standards to the IASB. Companies that operate on the international arena are particularly supportive of this. This goal itself is fundamental.
- The EU is also heavily involved in international standards and the European endorsement process broadly supports implementation, bearing in mind that once the standards are endorsed, they apply to consolidated financial statements for all listed companies whose securities trade in a regulated market.
- However, it is worth remembering that outside the EU and in practice, support for international standards varies. The position of the three other major world economic powers as measured by GNP does not match Europe's strong commitment, and on these markets, standards are either optional, or act as a convergence target or benchmark after a deliberate move to abandon more aggressive convergence.
- Divergence should not be sought, but it is not in the EU's interests to unilaterally rule out the option to adapt where necessary, just as the other major economic regions have left this option open.

5.2 Delegation of sovereignty implies strong and organised relationships

- The EU provided the IFRS Foundation with the necessary resources to fulfil the role it delegated when it became its main funding provider.
- With the EFRAG and the ARC, it also has the means to control this delegation, safeguarding its sovereignty. The resources provided to the preparer are not separable and are as vital as those required by its control.
- The necessity of reconciling the EU's sovereignty with the emphasis on the European public good and commitment to global accounting standards is not a reflection of doubts on a renowned technical body, but rather should be seen as the mark of a process to define balanced standards that safeguard the general interest.
- Some concepts such as full fair value, which embodies a theoretical and technical approach, ran up against the reality of democratic debate.
- Against this backdrop, the EU must have the wherewithal to keep a grip on its delegation right throughout the process.

5.3 Upholding and developing dialogue are key priorities

- Delegation by the EU and control of this process require continuous and extensive dialogue between the EU and the IFRS Foundation, and this must be driven by all possible means, developing and extending all possible avenues for communication.
- 1. Play an active role in IFRS Foundation governance. As expressed during the recent governance review of the IFRS Foundation and the 10-year appraisal of application of the standards, the EU still does not have its rightful leadership role in the foundation's governance bodies (IASB, IFRIC). Recent appointments and the geographical balance of forthcoming nominations remain a cause for concern in this respect;
- 2. Review communication channels between the EU and the IFRS Foundation. Setting aside the endorsement process, this communication currently consists of the EU's participation in the monitoring board and regular presentations from the Chairs of the IFRS Foundation trustees and board at the European Parliament. This set-up could perhaps be rounded out by a strategic protocol in the same vein as existing or past endeavours between the IFRS Foundation and other jurisdictions, such as the Beijing Joint Statement and the Norwalk agreement;
- 3. Contribute to preparatory conceptual work: in this respect ANC welcomes the recent creation of the Lab, which will help further extend discussions and European initiatives on concepts and expectations on non-financial reporting, particularly as regards sustainable finance;
- 4. Outline the difficulties early on during a strict and demanding endorsement process, which in the past has often helped identify certain conceptual difficulties or application problems that have prompted the IASB to revise its texts;
- 5. Extend the monitoring scope: the IASB has increased the number of sources of guidance to support implementation of standards (basis for conclusion, decisions from the interpretations committee, TRG, webinars, taxonomy, etc.). This change raises questions on the uniform application of international standards as well as the due process required by such guidance. Against this backdrop, the EU's endorsement process is obviously not involved in these developments and must adapt to these changes in order to cover these new sources for increasing standard-setting;
- 6. Put forward technical solutions: when the EU criticises a standard, it is already in a position to make a very clear appraisal and even take the initiative of proposing solutions to the Commission's and the European Parliament's questions (*Long term investment/equity impairment and recycling* from the EFRAG);
- 7. Once standards have been issued, contribute to the assessment of their potential effects via impact assessments, field tests, case studies and research, etc.
- 8. Continue negotiations towards full reciprocity of accounting standards with third countries' financial markets, particularly with the aim of ensuring that standards as endorsed by the EU are accepted there, just as the EU accepts several accounting standards, including national standards.

5.4 Admit the possibility of a failure but not be the cause of it

- The EU must take all possible steps to foster dialogue with the IASB in pursuit of the harmonisation goals it has set and in light of the delegation granted. However, the possibility of failure cannot be ruled out.
- The carve-in, just like other ways of adapting IFRS, reflects a failure of this dialogue through the fault of one or both parties. All possible steps must be taken to ensure that the EU is not the cause of this failure, but it must also be prepared to address this eventuality.
- Certain adaptations recognised to be necessary (IFRIC 21) have had to be rejected in the past due to the inability to adapt a standard before its issuance.
- The EU has also been in the position of having to introduce certain adaptations that the endorsement process did not provide for. Carve-outs were implemented in IAS 39 and IFRS 9 on macro-hedging and the fair value option; a top-up in the IFRS 4 amendment extended the scope of application deferral for IFRS 9 to bancassurers; the first time application for all consolidation standards (IFRS 10-12) was pushed back, etc.
- Fundamentally, a carve-in is similar to other current adaptation instruments (carve-out, top-up, deferral), which were deemed to be legitimate.
- Many in France believe that the EU should maintain the option of adding in an additional means of adaptation, on condition that this instrument – which is tantamount to admitting defeat – remains a deterrent and is subject to specific safeguards and a strict process, making it most powerful when it is not used.

Appendix 6: EU public policy objectives on accounting and non-financial information

6.1 The current procedure is adequate, but it is useful to clarify the EU's accounting public policy objectives

- The EU enjoys and can take advantage of both past experience and leadership on non-financial reporting. The Directive on non-Financial information and diversity information sets a broad framework for the non-financial information that must be included in companies' management reports. This general framework is applied in 2018, after Member States transpose into national legislation, and the directive also includes a practical guide for companies to help them define their strategy on this issue and decide how to present the indicators they have to report.
- France had already taken a number of initiatives in this field, particularly on CSR. This type of information is covered by European regulation, and is approved across the different levels of a company's governance. In other jurisdictions, this information is optional and is reported outside the financial statements, so it will not be subject to the same governance requirements.
- Some aspects, such as sustainable finance and long-term investment, have become much more important when endorsing international accounting standards than was probably initially expected. However, these aspects can of course be included in an up-to-date and broader definition of the European public good.
- Following the Maystadt Report, the European Commission drafted a non-paper, which seeks to define exactly what this notion includes: its meaning can and should be clarified and extended, and then updated regularly, while not changing the procedure and endorsement criteria themselves.
- Taking on board non-financial information is a key aspect of company reporting under European regulation, and efforts to make the way financial and non-financial information fit together more consistent and clear would go a long way to better organising financial reporting overall.

6.2 The extension of the EU's public policy objectives requires an assessment of the effects of these standards

- As noted by recent EU reports – especially work by the HLEG – and discussions during the endorsement of recent standards, it is important to think ahead to the potential transformative effects of accounting standards, particularly in terms of long-term investment and sustainable finance.
- This not only covers the focus on impact reports, but also means looking into the business model that underpins accounting conventions.
- For example, consideration on changes in standards has already highlighted that:
  - Long-term investment requires long-term commitment, which conflicts with the immediately available and tradable features of investment (trading) that certain standards foster;

- The viewpoint chosen that information is primarily intended for "investors" where finance promotes trading, debt instruments and securitisation, can encourage "the market" to transfer and focus financial risk on shares held by funds, so risk is then ultimately borne by savers (via pensions).
- Accounting requirements for decommissioning obligations or assets covering these liabilities should not encourage companies to dispose of them, when in fact they are best placed to manage them.

6.3 Continue the European initiative on consistent and relevant non-financial information

- The aim is not to create fresh requirements, but rather to assess the conceptual framework created by the Non-Financial and Diversity Information Directive and where necessary round it out with non-binding guidelines derived from best practices. More standardised and reliable information should channel capital and avoid the discount applied to less transparent companies, ultimately creating a competitive advantage.
- An initiative in this area, such as the recent set-up of the Lab, would enable Europe to achieve a level playing field with other participants, while safeguarding its sovereignty and hence set a framework for the emergence of private initiatives.
- Beyond the work already slated on environmental indicators following the Task Force on Climate-related Financial Disclosures (TCFD), we believe that the EU should continue its own independent consideration of other aspects of non-financial information; continue with the review of practices, particularly as regards how financial and non-financial information fit together, types of indicators, reliability of reports, the inclusion of all these data in a single report and their approval.

Appendix 7: Role of accounting concepts in standard-setting from EU standpoint

7.1 The international standard endorsement process must be based on an in-depth analysis of accounting concepts

- The primary criterion for standard endorsement in IAS regulation is that it complies with the principle of true and fair view in the light of the accounting directive.
- ANC therefore analysed what is involved in a true and fair view as outlined by the directive; this analysis can be found in Appendix A.
- Therefore, apart from the following two very specific situations, true and fair view is deemed to be provided when the financial statements comply with the provisions outlined in the directive.
  - The first specific situation is when application of the directive is inadequate to provide a true and fair view. Provisions must be followed, but additional information should also be provided.
  - The second situation is when in exceptional circumstances, application of the directive's provisions is incompatible with the requirement to provide a true and fair view. In this case, the provision is not applied and departure is mentioned in the appendix with the relevant explanations, and an indication of the impact on the company's assets, financial situation and results.
- Generally speaking, international accounting standards cannot be contrary to the accounting directive's provisions. For the practical purposes of endorsement, the term "not contrary" should be seen as a "negative" compliance (i.e. not strict compliance) with all provisions in the directive i.e. each of them.
- ANC therefore looked into the principles referred to in the directive, either explicitly or implicitly. This assessment shows that it is important to set these principles against those of the IASB when endorsing a standard, in order to ensure that the standard does not ultimately contradict the directive's aims.
- This conceptual analysis could also provide insight into some implementing measures for the directive, for example on fair value when companies opt to apply the option to use this alternative measure.
- ANC believes that this dialogue is necessary, but it is not advisable to put forward a European conceptual framework that would round out or replace the directive.

7.2 IASB conceptual framework should not be adopted in regulation

- We still agree with the Commission's comments expressed in November 2003, which recognised the existence of the conceptual framework as guidance, but ruled against endorsement of "regulation" in the body of work on the grounds that it was not a standard[1].
- Even looking to IFRS, this framework is not required for the standard-setting body (the IASB recognised that some provisions in the standards run contrary to the conceptual framework) or the preparer when standards advise that it refers to it (IAS 1, IAS 8).
- In the legal context created by the European directive, endorsing a text that could run contrary to standards already endorsed and that does not bind their Author could lead to highly complex legal situations.
- Furthermore, the various aspects of the IASB conceptual framework are not necessarily identical to the concepts outlined in the Single Accounting Directive: different meanings for the prudence principle (asymmetry or neutrality), range of users of financial reporting (narrower for IASB), role of the business model in selecting a valuation model between market value and historical cost, the ambiguity of including other comprehensive income (OCI) in the income statement (as in IFRS) or the balance sheet (as in the directive), notion of true and fair view (more comprehensive in the directive), etc.

[1] Comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting

Annexe A : Endorsement criteria in the IAS Regulation: True and Fair View principle

Key provisions on true and fair view: the IAS Regulation and the Accounting Directive

The key provisions on true and fair view are (i) the Accounting Directive and (ii) the IAS Regulation (and to a certain extent their recitals).

Providing a true and fair view is the first endorsement criterion set in Article 3(2) of the IAS Regulation (Regulation (EC) No 1606/2002):

> "*The international accounting standards can only be adopted if they are not contrary to the principle set out in Article 2(3) of Directive 78/660/EEC and in Article 16(3) of Directive 83/349/EEC.*"

> Both Articles 2(3) of Directive 78/660/EEC and 16(3) of Directive 83/349/EEC which establish the principle of true and fair view, are now merged and reported under Article 4(3) of the Accounting Directive (Directive 2013/34/EU).

In addition, at recital level, paragraph 9 offers a commentary on the linkage between the principle in Article 4(3) and an international accounting standard to be adopted :

> "*To adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of those Directives*".

Article 4(3) of the Directive 2013/34/EU ("Accounting Directive") which is referred to in the IAS Regulation states that:

> "*The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements*".

In addition, Article 4(4) of the Accounting Directive states that:

"Where in exceptional cases the application of a provision of this Directive is incompatible with the obligation laid down in paragraph 3, that provision shall be disapplied in order to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. The disapplication of any such provision shall be disclosed in the notes to the financial statements together with an explanation of the reasons for it and of its effect on the undertaking's assets, liabilities, financial position and profit or loss".

In addition, at recital level, paragraph 9 offers a commentary on the practical implementation of the true and fair view principle:

"Annual financial statements should be prepared on a prudent basis and should give a true and fair view of an undertaking's assets and liabilities, financial position and profit or loss. It is possible that, in exceptional cases, a financial statement does not give such a true and fair view where provisions of this Directive are applied. In such cases, the undertaking should depart from such provisions in order to give a true and fair view. The Member States should be allowed to define such exceptional cases and to lay down the relevant special rules which are to apply in those cases. Those exceptional cases should be understood to be only very unusual transactions and unusual situations and should, for instance, not be related to entire specific sectors".

Primary legal analysis of the provisions on the principle of true and fair view

True and fair view is the pivotal principle for the preparation of financial statements: "*The* […] *financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss*" (Accounting Directive, Article 4(3)).

Under normal circumstances, *"the application of the Directive"* is "*sufficient to give a true and fair view*" (Accounting Directive, Article 4(3), *a contrario*). As a consequence, except for those specific circumstances discussed below, a true and fair view is deemed to be given when the financial statements are prepared in accordance with the provisions of the Accounting Directive.

The first specific circumstance mentioned by the Directive is "*where the application of* [the] *Directive would not be sufficient*" (Accounting Directive, Article 4(3)). In such a circumstance, the Directive does not authorise to depart from its provisions, but requires additional information: "*such additional information as is necessary to comply with* [the true and fair view] *requirement shall be given in the notes*".

The second specific circumstance mentioned by the Directive is "*where in exceptional cases the application of a provision of this Directive is incompatible with the* [true and fair view] *obligation"* (Accounting Directive, Article 4(4)). In such a circumstance, the Accounting Directive requires that the provision be disapplied, such disapplication being "*disclosed* […] *together with an explanation of the reasons* […] *and* [the] *effect"*. Recital 9 provides some guidance on how to identify exceptional cases: "*those exceptional cases should be understood to be only very unusual transactions and unusual situations and should, for instance, not be related to entire specific sectors*".

The two specific circumstances discussed above indicate that either additional information in the notes is required (§ 0) or such cases must be exceptional (§ 0). This confirms that a true and fair view is derived from the application of the provisions of the Directive in most cases. The departure must be "exceptional" and duly justified. It is generally considered that the occurrence of exceptional cases is rare. As a consequence, the detailed provisions of the Directive constitute the references for a proper legal implementation of the true and fair view principle. The fact that the Directive offers options or could be considered as not specific enough on certain topics does not modify the legal linkage described above. It only offers, under the current circumstances, a more open context for implementation.

As far as international accounting standards to be adopted are concerned, the true and fair view principle as defined by the Accounting Directive (see above) does apply: "*The international accounting standards can only be adopted if they are not contrary to the principle* [of true and fair view]*"* (IAS Regulation, Article 3(2)). The term "not contrary" establishes the relationship between the international accounting standard to be adopted and the principle: it may be described as a "negative" compliance by contrast with a "positive" one. A positive compliance would imply that all the provisions (i.e. each and every provision) of the Directive (including the options offered) be reflected in the international accounting standards. By contrast, since the two systems have different objectives and characteristics, a negative compliance implies a different (and somehow lesser) degree of compliance.

The above legal relationship established by the IAS Regulation is further elaborated upon in Recital 9 which, though not binding, offers guidance: "*this principle* [of true and fair view] *being considered in the light of the said* [Directive] *without implying a strict conformity with each and every provision*". A "strict conformity" would imply "positive" compliance with each and every provision (including options) and no possibility to go further than the Directive itself in the absence of a provision. This is clearly not the intention of the Regulation. Operating "in the light of" confirms the spirit of "negative" compliance as described above.

As a consequence of § 0 and § 0 above, three practical situations may occur:

(i) The new standard complies with the provisions (or options) in the Directive. In such case, the link with the Directive is obvious and limited comments are expected (for instance justifying the choice of an option compared to another);

(ii) Where the Directive is silent, the new standard is "not contrary" to it and may apply, but additional information should be provided in order to mention and explain the situation;

(iii) The new standard departs from a provision (or options) in the Directive. Such a situation is not prohibited but should remain rare and well explained. Actually, the potential departure from the Directive's provisions is offered by the Directive itself (Art.4(4)) and is recalled in the IAS regulation (Recital 9) mentioning that the true and fair view has to be "considered in the light of" the Directive, the compliance to which may therefore not be "strict".

Other sources on true and fair view in Europe: Jurisprudence of the European Court of Justice

The European Court of Justice refers to the true and fair view principle of the Accounting directive in paragraph 72 and 74 of its (ECJ) Case C-306/99[2].

[2] Case C-306/99, Banque Internationale pour l'Afrique Occidentale SA (BIAO) and Finanzamt für Großunternehmen in Hamburg (07/01/2003)

§ 72 of (ECJ) Case C-306/99 states that:

"*Annual accounts must give a true and fair view of the company's assets and liabilities, financial position and profit or loss* […]*. That principle requires, first, that the annual accounts of companies should reflect the activities and transactions which they are supposed to describe and, secondly, that the accounting information be given in the form judged to be the soundest and most appropriate for satisfying third parties' needs for information, without harming the interests of the company.*"

This statement establishes the ECJ's view over the objectives of the true and fair view principle: (i) to reflect activities and transactions, (ii) in the soundest and most appropriate form.

§ 74 of (ECJ) Case C-306/99 states that:

"*The 'true and fair view' principle must also be understood in the light of other principles set out in Article 2 of the Fourth Directive. That means, in particular, the principle whereby the annual accounts, comprising the balance sheet, the profit and loss account and the notes on the accounts, are to constitute a composite whole (Article 2(1)), the principle that the annual accounts are to be drawn up clearly and in accordance with the provisions of that directive (Article 2(2)), and the principle that, where the application of the directive would not be sufficient to give a true and fair view within the meaning of Article 2(3), additional information must be given (Article 2(4))*".

Therefore, according to the ECJ, the "true and fair view principle" mainly means that "*the* […] *accounts are to be drawn up clearly and in accordance with the provisions of* [the] *directive".*

1 The primary legal analysis presented above is not in contradiction with the jurisprudence (though not related to IFRS matters).

Other sources on true and fair view in Europe: European Commission non paper

2 European Commission services have prepared a "non-paper" (considered, in its disclaimer, as "tentative" and "*not necessarily represent*[ing] *the correct and forthcoming EU legislation*" for the meeting of the Accounting Regulatory Committee (ARC) on 17th September 2015.

3 European Commission services state in this non-paper that:

"*The European legislation does not provide a distinct definition of the principle of true and fair, but the Court of Justice has reviewed the principle in its case-law over the years*".

As mentioned above, the absence of a distinct definition *per se* corresponds to the fact that a true and fair view is, by construction, derived from the application of the provisions of the Directive (with mitigations in case of insufficiency or incompatibility). It may be said that the definition is replaced by the key linkage to the provisions: the true and fair view is the consequence of applying the provisions.

As regard the Court of Justice, its case-law clearly clarifies, in particular, the link between the application of the provisions and the true and fair view.

European Commission services further state that:

"*It is reasonable to conclude that the true and fair view principle is the overarching principle, the primary objective of the* [Directive] *and the application of this principle must, as far as possible, be guided by the general principles contained in the* [Directive]".

This conclusion is clear. However it must be added that:

(i) the reference to "general principles" must include not only the principles stipulated by Article 6 of the Directive ("General financial information principles"), but more generally all the provisions of the Directive, as stipulated in Article 4(3) which does not restrict the legal linkage to Article 6 only. (See above "Primary legal analysis" and "ECJ Jurisprudence").

(ii) the term "guided" must be interpreted as "not contrary".

As a consequence the paragraph on practical application should be clarified.

Practical consequences for the endorsement process [tentative]

An international accounting standard cannot be contrary to the provisions of the Accounting Directive, in general. For implementation purposes, (i) the term "not contrary" must be interpreted as described under § 0 above and (ii) the term "provisions" must be understood as described under § 0 and further clarified under § 0 (i) above and in the light of paragraphs 0 to 0 above.

An endorsement advice should explain how an international accounting standard to be adopted can be considered as not contrary to the provisions of the Accounting Directive.

References

Council Directive 78/660/CEE, of 25 July 1978
Council Directive 83/149/CEE, of 13 June 1983
Council and European Parliament Directive 2013/34/UE, of 26 June 2013
Regulation n°1606/2002 of 19 July 2002
Case C-306/99, Banque Internationale pour l'Afrique Occidentale SA (BIAO) and Finanzamt für Großunternehmen in Hamburg (07/01/2003)
Non-paper of Commission Services DG FISMA "Meeting of the Accounting Regulatory Committee (ARC)" of 17 September 2015

Appendix 1: Greater convergence of financial reporting rules – who and why?

1.1 The Single Accounting Directive is part of a steady effort to harmonise financial statements within the European Union

- The European Union has pursued the goals of organising and harmonising financial information in Europe over the past forty years, following on from the accounting directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies.
- The Single Accounting Directive 2013/34/EU of 26 June 2013 is the successor to these development efforts. It sets out common principles for annual financial statements and consolidated financial statements, which had previously been governed by two different accounting directives that this new directive replaced. The Single Accounting Directive also aims to simplify accounting requirements for small and medium-sized companies and make it easier to compare financial statements across the entire European Union by reducing the number of options available to Member States as compared to the two previous directives.
- It has a general application in terms of both its scope, which covers all European companies (on condition that obligations are proportional to their size), and its consideration of the users of financial statements. From a legal standpoint, it plays a key role in the reporting of financial statements, combining with the two related accounting directives on the insurance and banking sectors to form a comprehensive corpus.
- The French accounting standards authority, *Autorité des normes comptables* (ANC), therefore notes the fundamental importance of the Single Accounting Directive for the European Union and its efforts to ensure accounting harmonisation and the development of the European public good on accounting issues.

1.2 It is perfectly commendable to look into the potential future changes in the accounting directive, but these efforts must serve to strengthen its substantial existing contribution. Before pursuing greater harmonisation, it is vital to first conduct an objective review of the Member States' use of the options currently included in the directive and set strategic targets. Difficulties in staging cross-border business are not an appropriate justification for overhauling the system.

<u>European Union (EU) is an easily accessible area for trade</u>

- The EU is broadly easily accessible to both European and third-country companies as compared to other areas of the world, assuming that they comply with certain conditions e.g. they must have a permanent establishment.
- The European Union applies harmonised rules across the single market to promote trade among Member States, while safeguarding the specific features of each State and the subsidiarity principle.

- From an accounting standpoint, the Single Accounting Directive sets out a shared financial reporting framework for all European companies, laying out the key principles and providing financial statement models. It dovetails with the two accounting directives on the insurance and banking sectors to provide a consistent corpus for the EU, while taking on board the specific features of the financial and non-financial sectors.
- The aim of a review of this unified accounting framework may be to develop cross-border business for European companies within this market, but it must be proven that reporting differences actually act as a hindrance, which is far from given.

<u>The main determining factor in a company's ability to conduct cross-border trade is the existence or not of an accessible market in the other State</u>

- The ability to develop cross-border economic activity within the single market hinges firstly on the existence of a market (its size and momentum, how open it is, the related risks and access conditions) and secondly on the ability to handle language and organisational differences on local markets i.e. administrative, tax, specific features of prospective clients.

<u>Against this backdrop, the various national reporting rules are a technical difficulty that should be set into context, rather than a real obstacle to conducting cross-border business</u>

- National differences in reporting rules are therefore secondary considerations in this respect, creating technical difficulties that are in no way an obstacle to developing business. They add further complexity and cost, particularly for translation, but these aspects should be set into context as these differences are not an impossible obstacle or a true hindrance to successfully conducting cross-border business.
- Differences in national regulations, particularly in terms of reporting, are costlier to manage for small companies than for larger businesses, so it is important to take on board this size aspect, which is what the accounting directive already endeavours to do.
- The costs generated by these differences are manageable overall. Certain areas can be simplified, especially for smaller companies, which suffer higher costs in relative terms, but there is no need to change the accounting standard as a whole just for this reason.
- It is obviously still useful to consider whether the convergence achieved by the accounting directive is appropriate, but this issue must be viewed in light of other criteria than the feasibility of conducting cross-border business, which is not particularly useful.

1.3 It is vital to carry out a review of Member States' use of the options available in directive 2013/34 before seeking greater accounting harmonisation

- Directive 2013/34, or the Single Accounting Directive, already provides a shared base of rules, some of which include options, although there are fewer options as compared with the directives that the Single Accounting Directive replaced. Before any fresh changes are made, it would be useful for the Commission to carry out a review with Member States of their use of the options provided for by the directive to help assess the extent of divergences and the potential ways to reduce them. Increased convergence does not necessarily require a decrease in the number of options, but rather a more detailed framework for the way they are applied.
- A small number of the current options involve significant issues. The directive lays out the general principle for the valuation method based on historical cost, while alternative valuation methods such as fair value and revaluation provide Member States with extensive flexibility in applying the directive to the detriment of the harmonisation sought. Conditions for application should therefore be more clearly defined Europe-wide in order to bolster the general principle. It is useful to identify the number of options used, but it is also key to assess how they are applied: this process does not seek to undermine the existence of these options, but rather it could be helpful in better regulating the ways they are applied across Europe by reducing their scope and making them more consistent with the directive's general principles. It is worth noting that the fair value option outlined in the directive enables users to apply fair value accounting more extensively than international standards, thereby creating greater complexity and volatility, running contrary to the needs of unlisted companies.

1.4 Which companies need stronger reporting rules?

<u>Specific uniform rules for companies with cross-border business are not necessary</u>

- A specific accounting framework for companies with cross-border business is unnecessary: this type of set-up would mean that a company that endeavours and fails to expand its operations internationally would have to change its accounting rules just for this reason.
- Another point worth noting is that cross-border business usually involves a very specific group of large companies, while small and medium-sized companies are usually local and their business operates on a domestic scale. Applying a different set of accounting standards as soon as these smaller companies embark on international business could well create an additional curb on their business from the outset.
- The most important aspect for smaller entities is the relatively high cost of the requirement to take on board a new set of accounting standards, as compared with their size.

Application of uniform rules for companies proportionate to their size must be maintained

- It is vital to maintain a single set of accounting principles for statutory accounts to ensure easier comparison of companies and in the interests of the common European good: all companies apply the same standards and can simplify depending on their size.
- The issue of increased convergence within the EU should be addressed differently depending on the companies in question.
- It is important to identify European companies that apply IFRS and achieve accounting harmonisation, thus meeting the markets' financial information requirements on the one hand, and other companies that do not need such extensive European harmonisation on the other.

Appendix 2: The accounting directive is an essential starting point for single financial reporting for all users

2.1 Different uses and different users of financial statements

- Statutory accounts can be used for a number of different purposes: they are used as the basis for legal conditions on companies' payout; they provide the foundations for tax law, regardless of the extent of reconciliation between financial statements and tax reports, and regardless of the size of companies; they are used to provide employee information and as a management performance metric; lastly, for companies that are not subject to IFRS, these accounts are additionally used as information for third parties i.e. local lenders such as banks and factoring companies.
- Statutory accounts provide the common denominator for these various different uses.
- Meanwhile unlisted companies in France can decide between two sets of standards when filing their consolidated accounts – French consolidation rules or IFRS as endorsed by the European Union. The French standards allow for a less complex, less legal and more business-oriented presentation, which is particularly useful for banks and companies' main creditors. Once again, it is important to develop accounting standards that take on board users' requirements in this respect.

2.2 Reiterate accounting rules as the foundations for consistent financial reporting, suited to the requirements of its various users

- It is vital that European financial reporting rules play a role in strengthening the intra-European market as regards a range of other related issues i.e. promotion of tax cohesion within the European Union, consideration of needs of all users of financial statements, aim of avoiding excessive reporting requirements for companies.
- In the accounting directive context, users are not just investors and lenders, as accounts models in particular also include information for staff, the Directorate General for Enterprise, public administrations and creditors.
- The current framework is appropriate and should not be extended. The EU accounting framework is part of a broader European set-up that covers all aspects of corporate reporting obligations; financial statements, the corporate governance report and the management report cover a very wide scope and provide information on a company's or group's strategy and business model.

- It is important to correctly define financial information to ensure that legal rules on dividend pay-out and tax rules on company income are properly applied. The common consolidated corporate tax base (CCCTB) initiative currently being discussed requires great attention to the way the existing accounting directive and these future EU regulations fit together. Tax and accounting standards must be taken forward at the same time, as both are important in assessing economic performances.
- On a similar note, accounting standards should provide for performance indicators if they are to be used for the purposes of these standards. Yet Council directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the interternal market (currently undergoing implementation into national legislation) sets up a system for restricting tax deduction of interest expense based on a percentage of companies' EBITDA. This directive provides a definition for EBITDA solely for the purposes of this regulation, but this reflects the need to consider the role of EU-wide accounting standards in defining these indicators used for the purposes of these standards. This does not mean trying to define all alternative management indicators, as they would then become useless as a way of reflecting the specific features of each company, unless each company explains the indicator's components and ensures that it remains constant.

2.3 Application of pan-European accounting rules for groups (IFRS, IFRS for SMEs, etc.) would mean running the risk of creating a multi-speed European Union

- The introduction of an additional pan-European set of standards for groups raises the risk of hampering harmonisation goals and failing to take on board European interests, particularly as the European Union would not be in charge of maintaining and developing these standards.
- Implementation of a pan-European standard, which would be optional for unlisted groups, will not help simplify their business operations across the EU as companies would still have to file financial statements for tax purposes and dividend payout calculations in each State, which would not help make the situation any more straightforward.
- This would raise difficulties on both harmonisation and comparison between companies, so two companies in the same Member State would have different situations, depending on whether they are part of a group or not.
- In light of these various issues, implementation of a pan-European set of standards must be considered with great caution.

Appendix 3: Relationship between common accounting and tax rules in the European Union

As an introductory remark, it looks premature to consider the potential accounting consequences of implementation of the common consolidated corporate tax base, given that negotiations on the proposed directive are currently under way.

3.1 Accounting must act as the linchpin for financial reporting and a benchmark for tax and legal matters for payout purposes, rather than the opposite.

- Accounting is a way of assessing economic performances and aims to measure and provide information on an entity's business results. Tax liable as a result of a company's business performances must therefore be based on accounting figures, and the reverse approach would not be coherent. Similarly, economic performances also provide the basis for paying out dividends.
- It is worth discussing the ways to harmonise performance measurement, and it is not coherent to use different company performance measurement systems for dividend purposes, tax and economic performances. Tax obviously serves to meet economic and fiscal policy goals, which should be clearly distinguished from accounting, but these differences must be limited and based on economic reality to ensure that they remain relevant.

3.2 Tax-accounting convergence should be promoted as it simplifies matters for companies, which then only have one set of standards to manage and declare, and also for authorities, helping creating a coherent environment.

- Accounting is the best way to portray companies' economic transactions and should naturally act as the starting point for any related regulation, whether tax or legal, so a strong relationship between regulation and accounting is the ideal situation for Europe and a target to be pursued.
- A decision to establish a clear relationship between accounting and tax, as is the case in France, requires the production of statutory accounts using the same accounting standards for all companies. If there is to be a clear correspondence between tax and accounting, as ANC supports, this firstly requires the development of common accounting rather than tax rules.
- In light of these various factors, tax and accounting standards should be developed at the same time, and the European Union must ensure that progress is made simultaneously on these two aspects.

Appendix 4: Promote European accounting principles for annual accounts and consolidated accounts for unlisted companies

- The Single Accounting Directive includes general principles with varying degrees of assertion and expressly defined i.e. prudence, true and fair view. Adding a conceptual framework to this directive would not provide any additional advantages and would actually raise a number of questions on how the conceptual framework and the directive fit together.
- The accounting directive's general principles must also be highlighted and reiterated both when developing local standards in the different Member States as well as endorsing international standards.
- Moves to enhance, specify and develop the scope of these principles would help strengthen the European Union's role in accounting discussions and in the future act to promote increased harmonisation in the area.
- Similarly, this European accounting framework must change and evolve to take on board changes in companies' environments where necessary. It is essential that the accounting framework be suited to the requirements of the various stakeholders, enabling them to deal with new transactions.
- However, moves to deepen the European accounting framework first require an extensive review of potential differences between the Member States and a clear strategic goal, outlined in cooperation with all stakeholders.

Appendix 5: How the EU delegates and monitors development of accounting standards

5.1 The European Union is the most involved area in global international accounting standards

- The EU gave a clear signal of its emphasis on global accounting standards when it opted to delegate development of accounting standards to the IASB. Companies that operate on the international arena are particularly supportive of this. This goal itself is fundamental.
- The EU is also heavily involved in international standards and the European endorsement process broadly supports implementation, bearing in mind that once the standards are endorsed, they apply to consolidated financial statements for all listed companies whose securities trade in a regulated market.
- However, it is worth remembering that outside the EU and in practice, support for international standards varies. The position of the three other major world economic powers as measured by GNP does not match Europe's strong commitment, and on these markets, standards are either optional, or act as a convergence target or benchmark after a deliberate move to abandon more aggressive convergence.
- Divergence should not be sought, but it is not in the EU's interests to unilaterally rule out the option to adapt where necessary, just as the other major economic regions have left this option open.

5.2 Delegation of sovereignty implies strong and organised relationships

- The EU provided the IFRS Foundation with the necessary resources to fulfil the role it delegated when it became its main funding provider.
- With the EFRAG and the ARC, it also has the means to control this delegation, safeguarding its sovereignty. The resources provided to the preparer are not separable and are as vital as those required by its control.
- The necessity of reconciling the EU's sovereignty with the emphasis on the European public good and commitment to global accounting standards is not a reflection of doubts on a renowned technical body, but rather should be seen as the mark of a process to define balanced standards that safeguard the general interest.
- Some concepts such as full fair value, which embodies a theoretical and technical approach, ran up against the reality of democratic debate.
- Against this backdrop, the EU must have the wherewithal to keep a grip on its delegation right throughout the process.

5.3 Upholding and developing dialogue are key priorities

- Delegation by the EU and control of this process require continuous and extensive dialogue between the EU and the IFRS Foundation, and this must be driven by all possible means, developing and extending all possible avenues for communication.
- 1. Play an active role in IFRS Foundation governance. As expressed during the recent governance review of the IFRS Foundation and the 10-year appraisal of application of the standards, the EU still does not have its rightful leadership role in the foundation's governance bodies (IASB, IFRIC). Recent appointments and the geographical balance of forthcoming nominations remain a cause for concern in this respect;
- 2. Review communication channels between the EU and the IFRS Foundation. Setting aside the endorsement process, this communication currently consists of the EU's participation in the monitoring board and regular presentations from the Chairs of the IFRS Foundation trustees and board at the European Parliament. This set-up could perhaps be rounded out by a strategic protocol in the same vein as existing or past endeavours between the IFRS Foundation and other jurisdictions, such as the Beijing Joint Statement and the Norwalk agreement;
- 3. Contribute to preparatory conceptual work: in this respect ANC welcomes the recent creation of the Lab, which will help further extend discussions and European initiatives on concepts and expectations on non-financial reporting, particularly as regards sustainable finance;
- 4. Outline the difficulties early on during a strict and demanding endorsement process, which in the past has often helped identify certain conceptual difficulties or application problems that have prompted the IASB to revise its texts;
- 5. Extend the monitoring scope: the IASB has increased the number of sources of guidance to support implementation of standards (basis for conclusion, decisions from the interpretations committee, TRG, webinars, taxonomy, etc.). This change raises questions on the uniform application of international standards as well as the due process required by such guidance. Against this backdrop, the EU's endorsement process is obviously not involved in these developments and must adapt to these changes in order to cover these new sources for increasing standard-setting;
- 6. Put forward technical solutions: when the EU criticises a standard, it is already in a position to make a very clear appraisal and even take the initiative of proposing solutions to the Commission's and the European Parliament's questions (*Long term investment/equity impairment and recycling* from the EFRAG);
- 7. Once standards have been issued, contribute to the assessment of their potential effects via impact assessments, field tests, case studies and research, etc.
- 8. Continue negotiations towards full reciprocity of accounting standards with third countries' financial markets, particularly with the aim of ensuring that standards as endorsed by the EU are accepted there, just as the EU accepts several accounting standards, including national standards.

5.4 Admit the possibility of a failure but not be the cause of it

- The EU must take all possible steps to foster dialogue with the IASB in pursuit of the harmonisation goals it has set and in light of the delegation granted. However, the possibility of failure cannot be ruled out.
- The carve-in, just like other ways of adapting IFRS, reflects a failure of this dialogue through the fault of one or both parties. All possible steps must be taken to ensure that the EU is not the cause of this failure, but it must also be prepared to address this eventuality.
- Certain adaptations recognised to be necessary (IFRIC 21) have had to be rejected in the past due to the inability to adapt a standard before its issuance.
- The EU has also been in the position of having to introduce certain adaptations that the endorsement process did not provide for. Carve-outs were implemented in IAS 39 and IFRS 9 on macro-hedging and the fair value option; a top-up in the IFRS 4 amendment extended the scope of application deferral for IFRS 9 to bancassurers; the first time application for all consolidation standards (IFRS 10-12) was pushed back, etc.
- Fundamentally, a carve-in is similar to other current adaptation instruments (carve-out, top-up, deferral), which were deemed to be legitimate.
- Many in France believe that the EU should maintain the option of adding in an additional means of adaptation, on condition that this instrument – which is tantamount to admitting defeat – remains a deterrent and is subject to specific safeguards and a strict process, making it most powerful when it is not used.

Appendix 6: EU public policy objectives on accounting and non-financial information

6.1 The current procedure is adequate, but it is useful to clarify the EU's accounting public policy objectives

- The EU enjoys and can take advantage of both past experience and leadership on non-financial reporting. The Directive on non-Financial information and diversity information sets a broad framework for the non-financial information that must be included in companies' management reports. This general framework is applied in 2018, after Member States transpose into national legislation, and the directive also includes a practical guide for companies to help them define their strategy on this issue and decide how to present the indicators they have to report.
- France had already taken a number of initiatives in this field, particularly on CSR. This type of information is covered by European regulation, and is approved across the different levels of a company's governance. In other jurisdictions, this information is optional and is reported outside the financial statements, so it will not be subject to the same governance requirements.
- Some aspects, such as sustainable finance and long-term investment, have become much more important when endorsing international accounting standards than was probably initially expected. However, these aspects can of course be included in an up-to-date and broader definition of the European public good.
- Following the Maystadt Report, the European Commission drafted a non-paper, which seeks to define exactly what this notion includes: its meaning can and should be clarified and extended, and then updated regularly, while not changing the procedure and endorsement criteria themselves.
- Taking on board non-financial information is a key aspect of company reporting under European regulation, and efforts to make the way financial and non-financial information fit together more consistent and clear would go a long way to better organising financial reporting overall.

6.2 The extension of the EU's public policy objectives requires an assessment of the effects of these standards

- As noted by recent EU reports – especially work by the HLEG – and discussions during the endorsement of recent standards, it is important to think ahead to the potential transformative effects of accounting standards, particularly in terms of long-term investment and sustainable finance.
- This not only covers the focus on impact reports, but also means looking into the business model that underpins accounting conventions.
- For example, consideration on changes in standards has already highlighted that:
  - Long-term investment requires long-term commitment, which conflicts with the immediately available and tradable features of investment (trading) that certain standards foster;

- The viewpoint chosen that information is primarily intended for "investors" where finance promotes trading, debt instruments and securitisation, can encourage "the market" to transfer and focus financial risk on shares held by funds, so risk is then ultimately borne by savers (via pensions).
- Accounting requirements for decommissioning obligations or assets covering these liabilities should not encourage companies to dispose of them, when in fact they are best placed to manage them.

6.3 Continue the European initiative on consistent and relevant non-financial information

- The aim is not to create fresh requirements, but rather to assess the conceptual framework created by the Non-Financial and Diversity Information Directive and where necessary round it out with non-binding guidelines derived from best practices. More standardised and reliable information should channel capital and avoid the discount applied to less transparent companies, ultimately creating a competitive advantage.
- An initiative in this area, such as the recent set-up of the Lab, would enable Europe to achieve a level playing field with other participants, while safeguarding its sovereignty and hence set a framework for the emergence of private initiatives.
- Beyond the work already slated on environmental indicators following the Task Force on Climate-related Financial Disclosures (TCFD), we believe that the EU should continue its own independent consideration of other aspects of non-financial information; continue with the review of practices, particularly as regards how financial and non-financial information fit together, types of indicators, reliability of reports, the inclusion of all these data in a single report and their approval.

Appendix 7: Role of accounting concepts in standard-setting from EU standpoint

7.1 The international standard endorsement process must be based on an in-depth analysis of accounting concepts

- The primary criterion for standard endorsement in IAS regulation is that it complies with the principle of true and fair view in the light of the accounting directive.
- ANC therefore analysed what is involved in a true and fair view as outlined by the directive; this analysis can be found in Appendix A.
- Therefore, apart from the following two very specific situations, true and fair view is deemed to be provided when the financial statements comply with the provisions outlined in the directive.
  - The first specific situation is when application of the directive is inadequate to provide a true and fair view. Provisions must be followed, but additional information should also be provided.
  - The second situation is when in exceptional circumstances, application of the directive's provisions is incompatible with the requirement to provide a true and fair view. In this case, the provision is not applied and departure is mentioned in the appendix with the relevant explanations, and an indication of the impact on the company's assets, financial situation and results.
- Generally speaking, international accounting standards cannot be contrary to the accounting directive's provisions. For the practical purposes of endorsement, the term "not contrary" should be seen as a "negative" compliance (i.e. not strict compliance) with all provisions in the directive i.e. each of them.
- ANC therefore looked into the principles referred to in the directive, either explicitly or implicitly. This assessment shows that it is important to set these principles against those of the IASB when endorsing a standard, in order to ensure that the standard does not ultimately contradict the directive's aims.
- This conceptual analysis could also provide insight into some implementing measures for the directive, for example on fair value when companies opt to apply the option to use this alternative measure.
- ANC believes that this dialogue is necessary, but it is not advisable to put forward a European conceptual framework that would round out or replace the directive.

7.2 IASB conceptual framework should not be adopted in regulation

- We still agree with the Commission's comments expressed in November 2003, which recognised the existence of the conceptual framework as guidance, but ruled against endorsement of "regulation" in the body of work on the grounds that it was not a standard[1].
- Even looking to IFRS, this framework is not required for the standard-setting body (the IASB recognised that some provisions in the standards run contrary to the conceptual framework) or the preparer when standards advise that it refers to it (IAS 1, IAS 8).
- In the legal context created by the European directive, endorsing a text that could run contrary to standards already endorsed and that does not bind their Author could lead to highly complex legal situations.
- Furthermore, the various aspects of the IASB conceptual framework are not necessarily identical to the concepts outlined in the Single Accounting Directive: different meanings for the prudence principle (asymmetry or neutrality), range of users of financial reporting (narrower for IASB), role of the business model in selecting a valuation model between market value and historical cost, the ambiguity of including other comprehensive income (OCI) in the income statement (as in IFRS) or the balance sheet (as in the directive), notion of true and fair view (more comprehensive in the directive), etc.

[1] Comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting

Annexe A : Endorsement criteria in the IAS Regulation: True and Fair View principle

Key provisions on true and fair view: the IAS Regulation and the Accounting Directive

The key provisions on true and fair view are (i) the Accounting Directive and (ii) the IAS Regulation (and to a certain extent their recitals).

Providing a true and fair view is the first endorsement criterion set in Article 3(2) of the IAS Regulation (Regulation (EC) No 1606/2002):

> "*The international accounting standards can only be adopted if they are not contrary to the principle set out in Article 2(3) of Directive 78/660/EEC and in Article 16(3) of Directive 83/349/EEC.*"
>
> Both Articles 2(3) of Directive 78/660/EEC and 16(3) of Directive 83/349/EEC which establish the principle of true and fair view, are now merged and reported under Article 4(3) of the Accounting Directive (Directive 2013/34/EU).

In addition, at recital level, paragraph 9 offers a commentary on the linkage between the principle in Article 4(3) and an international accounting standard to be adopted :

> "*To adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of those Directives*".

Article 4(3) of the Directive 2013/34/EU ("Accounting Directive") which is referred to in the IAS Regulation states that:

> "*The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements*".

In addition, Article 4(4) of the Accounting Directive states that:

"Where in exceptional cases the application of a provision of this Directive is incompatible with the obligation laid down in paragraph 3, that provision shall be disapplied in order to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. The disapplication of any such provision shall be disclosed in the notes to the financial statements together with an explanation of the reasons for it and of its effect on the undertaking's assets, liabilities, financial position and profit or loss".

In addition, at recital level, paragraph 9 offers a commentary on the practical implementation of the true and fair view principle:

"Annual financial statements should be prepared on a prudent basis and should give a true and fair view of an undertaking's assets and liabilities, financial position and profit or loss. It is possible that, in exceptional cases, a financial statement does not give such a true and fair view where provisions of this Directive are applied. In such cases, the undertaking should depart from such provisions in order to give a true and fair view. The Member States should be allowed to define such exceptional cases and to lay down the relevant special rules which are to apply in those cases. Those exceptional cases should be understood to be only very unusual transactions and unusual situations and should, for instance, not be related to entire specific sectors".

Primary legal analysis of the provisions on the principle of true and fair view

True and fair view is the pivotal principle for the preparation of financial statements: "*The* […] *financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss*" (Accounting Directive, Article 4(3)).

Under normal circumstances, *"the application of the Directive"* is "*sufficient to give a true and fair view*" (Accounting Directive, Article 4(3), *a contrario*). As a consequence, except for those specific circumstances discussed below, a true and fair view is deemed to be given when the financial statements are prepared in accordance with the provisions of the Accounting Directive.

The first specific circumstance mentioned by the Directive is "*where the application of* [the] *Directive would not be sufficient*" (Accounting Directive, Article 4(3)). In such a circumstance, the Directive does not authorise to depart from its provisions, but requires additional information: "*such additional information as is necessary to comply with* [the true and fair view] *requirement shall be given in the notes*".

The second specific circumstance mentioned by the Directive is "*where in exceptional cases the application of a provision of this Directive is incompatible with the* [true and fair view] *obligation"* (Accounting Directive, Article 4(4)). In such a circumstance, the Accounting Directive requires that the provision be disapplied, such disapplication being "*disclosed* […] *together with an explanation of the reasons* […] *and* [the] *effect"*. Recital 9 provides some guidance on how to identify exceptional cases: "*those exceptional cases should be understood to be only very unusual transactions and unusual situations and should, for instance, not be related to entire specific sectors*".

The two specific circumstances discussed above indicate that either additional information in the notes is required (§ 0) or such cases must be exceptional (§ 0). This confirms that a true and fair view is derived from the application of the provisions of the Directive in most cases. The departure must be "exceptional" and duly justified. It is generally considered that the occurrence of exceptional cases is rare. As a consequence, the detailed provisions of the Directive constitute the references for a proper legal implementation of the true and fair view principle. The fact that the Directive offers options or could be considered as not specific enough on certain topics does not modify the legal linkage described above. It only offers, under the current circumstances, a more open context for implementation.

As far as international accounting standards to be adopted are concerned, the true and fair view principle as defined by the Accounting Directive (see above) does apply: "*The international accounting standards can only be adopted if they are not contrary to the principle* [of true and fair view]*"* (IAS Regulation, Article 3(2)). The term "not contrary" establishes the relationship between the international accounting standard to be adopted and the principle: it may be described as a "negative" compliance by contrast with a "positive" one. A positive compliance would imply that all the provisions (i.e. each and every provision) of the Directive (including the options offered) be reflected in the international accounting standards. By contrast, since the two systems have different objectives and characteristics, a negative compliance implies a different (and somehow lesser) degree of compliance.

The above legal relationship established by the IAS Regulation is further elaborated upon in Recital 9 which, though not binding, offers guidance: "*this principle* [of true and fair view] *being considered in the light of the said* [Directive] *without implying a strict conformity with each and every provision*". A "strict conformity" would imply "positive" compliance with each and every provision (including options) and no possibility to go further than the Directive itself in the absence of a provision. This is clearly not the intention of the Regulation. Operating "in the light of" confirms the spirit of "negative" compliance as described above.

As a consequence of § 0 and § 0 above, three practical situations may occur:

(i) The new standard complies with the provisions (or options) in the Directive. In such case, the link with the Directive is obvious and limited comments are expected (for instance justifying the choice of an option compared to another);

(ii) Where the Directive is silent, the new standard is "not contrary" to it and may apply, but additional information should be provided in order to mention and explain the situation;

(iii) The new standard departs from a provision (or options) in the Directive. Such a situation is not prohibited but should remain rare and well explained. Actually, the potential departure from the Directive's provisions is offered by the Directive itself (Art.4(4)) and is recalled in the IAS regulation (Recital 9) mentioning that the true and fair view has to be "considered in the light of" the Directive, the compliance to which may therefore not be "strict".

Other sources on true and fair view in Europe: Jurisprudence of the European Court of Justice

The European Court of Justice refers to the true and fair view principle of the Accounting directive in paragraph 72 and 74 of its (ECJ) Case C-306/99[2].

[2] Case C-306/99, Banque Internationale pour l'Afrique Occidentale SA (BIAO) and Finanzamt für Großunternehmen in Hamburg (07/01/2003)

§ 72 of (ECJ) Case C-306/99 states that:

"*Annual accounts must give a true and fair view of the company's assets and liabilities, financial position and profit or loss* […]. *That principle requires, first, that the annual accounts of companies should reflect the activities and transactions which they are supposed to describe and, secondly, that the accounting information be given in the form judged to be the soundest and most appropriate for satisfying third parties' needs for information, without harming the interests of the company.*"

This statement establishes the ECJ's view over the objectives of the true and fair view principle: (i) to reflect activities and transactions, (ii) in the soundest and most appropriate form.

§ 74 of (ECJ) Case C-306/99 states that:

"*The 'true and fair view' principle must also be understood in the light of other principles set out in Article 2 of the Fourth Directive. That means, in particular, the principle whereby the annual accounts, comprising the balance sheet, the profit and loss account and the notes on the accounts, are to constitute a composite whole (Article 2(1)), the principle that the annual accounts are to be drawn up clearly and in accordance with the provisions of that directive (Article 2(2)), and the principle that, where the application of the directive would not be sufficient to give a true and fair view within the meaning of Article 2(3), additional information must be given (Article 2(4))*".

Therefore, according to the ECJ, the "true and fair view principle" mainly means that "*the* […] *accounts are to be drawn up clearly and in accordance with the provisions of* [the] *directive".*

1 The primary legal analysis presented above is not in contradiction with the jurisprudence (though not related to IFRS matters).

Other sources on true and fair view in Europe: European Commission non paper

2 European Commission services have prepared a "non-paper" (considered, in its disclaimer, as "tentative" and "*not necessarily represent*[ing] *the correct and forthcoming EU legislation*" for the meeting of the Accounting Regulatory Committee (ARC) on 17th September 2015.

3 European Commission services state in this non-paper that:

"*The European legislation does not provide a distinct definition of the principle of true and fair, but the Court of Justice has reviewed the principle in its case-law over the years*".

As mentioned above, the absence of a distinct definition *per se* corresponds to the fact that a true and fair view is, by construction, derived from the application of the provisions of the Directive (with mitigations in case of insufficiency or incompatibility). It may be said that the definition is replaced by the key linkage to the provisions: the true and fair view is the consequence of applying the provisions.

As regard the Court of Justice, its case-law clearly clarifies, in particular, the link between the application of the provisions and the true and fair view.

European Commission services further state that:

"*It is reasonable to conclude that the true and fair view principle is the overarching principle, the primary objective of the* [Directive] *and the application of this principle must, as far as possible, be guided by the general principles contained in the* [Directive]".

This conclusion is clear. However it must be added that:

(i) the reference to "general principles" must include not only the principles stipulated by Article 6 of the Directive ("General financial information principles"), but more generally all the provisions of the Directive, as stipulated in Article 4(3) which does not restrict the legal linkage to Article 6 only. (See above "Primary legal analysis" and "ECJ Jurisprudence").

(ii) the term "guided" must be interpreted as "not contrary".

As a consequence the paragraph on practical application should be clarified.

Practical consequences for the endorsement process [tentative]

An international accounting standard cannot be contrary to the provisions of the Accounting Directive, in general. For implementation purposes, (i) the term "not contrary" must be interpreted as described under § 0 above and (ii) the term "provisions" must be understood as described under § 0 and further clarified under § 0 (i) above and in the light of paragraphs 0 to 0 above.

An endorsement advice should explain how an international accounting standard to be adopted can be considered as not contrary to the provisions of the Accounting Directive.

References

Council Directive 78/660/CEE, of 25 July 1978
Council Directive 83/149/CEE, of 13 June 1983
Council and European Parliament Directive 2013/34/UE, of 26 June 2013
Regulation n°1606/2002 of 19 July 2002
Case C-306/99, Banque Internationale pour l'Afrique Occidentale SA (BIAO) and Finanzamt für Großunternehmen in Hamburg (07/01/2003)
Non-paper of Commission Services DG FISMA "Meeting of the Accounting Regulatory Committee (ARC)" of 17 September 2015