Changes in EC Directives and Impact on Presentation of Financial Statements in the Czech Republic[#]

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Introduction

One of useful analysis on financial reporting needs of companies and determination of levels of financial reporting regulation has been prepared by the UNCTAD (2007) nearly ten years ago. The UNCTAD/ISAR Accounting and Financial Reporting Guidelines for Small and Medium-Sized Enterprises (SMEGA) identify three levels of regulation. Level 1: Listed entities whose securities are publicly traded and those with significant public interest should follow IFRSs. Level 2: Significant commercial, industrial and business entities that issue neither public securities nor financial reports to the general public may follow a single set of requirements derived from IFRSs and consistent with them, but embodying only the simplest and most regularly encountered transactions. Level 3: The smallest entities that are owner-managed should follow a simple accruals based accounting system (producing a simple balance sheet, a profit and loss account and reduced notes), closely linked to cash transactions, and with a derogation for businesses to use cash accounting for a limited time when establishing their accounting systems. Such a system should be consistent with the requirements of IFRSs, although not fully compliant.

European Commission respected the requirement to modernize the way of financial reporting and accounting regulation in Europe. Even it may be easier and less costly for Member States to adopt the IASB´s SME standards, European Commission proposed to simplify the Fourth and Seventh Council Directives as regards financial information obligations and to reduce administrative burdens, in particular for SMEs. Despite the

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fact that coordination of national provisions concerning the presentation and content of annual financial statements has been realized, this article investigates impact of new Directives´ financial reporting requirements on financial reporting of companies those use local regulatory rules, which should comply with the Directive of June 26, 2013 repealing the 1978 and 1983 Directives and their subsequent amendments (EC, 2013b), in the Czech Republic.

Conclusion from this article might be useful for practice as for the potential future changes in presentation of financial statements or researchers who find out similarities or differences between European accounting systems.

Conceptual background for changes in EC Directives

The EC 4th Directive[1] has been in force since 1978, at least till 2001 without fundamental changes. Nearly the same history concerns the EC 7th Directive[2], firstly issued in 1983. Since 2001, amendments to the Directives have been realised. New requirements, such as new disclosures and valuation rules, including detailed provisions on fair value accounting, have been added. As follows from different European procedures, based on research studies, like Communication on a simplified business environment for companies in the areas of company law, accounting and auditing (EC, 2007) and Project on baseline measurement and reduction of administrative costs (Consortium (CapGemini, Deloitte, Ramboll), 2008), less attention has been paid to considering whether existing requirements could be simplified or removed. Mentioned studies confirm that amendments have tended to ignore the comparability and usefulness of the financial statements, increased reporting requirements and the number of Member State options. All these facts have ultimately, in the long run, led to increased complexity and regulatory burden for all companies. As confirm other EC Communication EC (2008), shortly described as „Think Small First“, this increased burden bears down primarily on smaller companies. The Europe 2020 (EC, 2013b) Strategy aims to make the EU a smarter, more sustainable and inclusive economy. The strategy aims to simplify life for SMEs, which represent up more than 99% of Europe's businesses, and to improve these companies' access to finance.

[1] Fourth Council Directive of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies (78/660/EEC)

[2] Seventh Council Directive of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts (83/349/EEC)

The process of simplification started by investigation the thresholds which determine whether a company is ‘small’, ‘medium’ or large. Seeking definitions of micro, small and medium-sized enterprises has been realized in Europe since 2003. Consultations with Member States have indicated that the size criteria for micro-enterprises in the Recommendation[3] may be too high for accounting purposes. From the existing research results seemed to be very efficient to introduce another category of entities for the purpose of their accounting regulation.

Therefore, a sub-group of micro-enterprises, so-called "micro-entities", were introduced to cover companies with lower size criteria for balance sheet total and net turnover than those laid down for micro-enterprises. Regulatory rules for accounting should be prepared with the possibility to exempt micro-entities from certain obligations that may impose on them an onerous administrative burden. But on the other hand, micro-entities should still be subject to any national obligation to keep records showing their business transactions and financial position. With respect to this strategic decision, works on regulation for micro-entities has been separated from those ones on the EC 4th and 7th Directives´ amendments and modernisations.

Micros Directive

The first proposal of European Commission, in February 2009, for a micro-entity directive allows Member States completely abolish financial reporting requirements for the micro-entities (EC, 2009a). As some of member States were strongly against the proposal, European Council issued a new one, in 2011. The Directive[4] regarding micro-entities has been finally issued in March 2012. This Directive relieves the smallest companies of certain obligations imposed by the EC 4th, which establishes minimum requirements for the individual annual accounts of companies and certain partnership. Adopting the „Micros Directive“, Member States should ensure that micro-entities that are to be consolidated under the 7th Council Directive are without prejudice to the obligation to prepare consolidated accounts in accordance with this Directive.

The EC defined micro-entities as companies not exceeding two of the three following criteria:

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3 Commission Recommendation 2003/361/EC.

4 Directive 2012/6/EU of The European Parliament and of the Council of 14 March 2012.

1. balance sheet total: EUR 350,000;
2. net turnover: EUR 700,000;
3. average number of employees: 10.

The aim of the Directive is to enable Member States to create a simple financial reporting environment for micro-entities. Companies preparing micro accounts cannot use fair value accounting. The use of fair values can result in the need for detailed disclosures to explain the basis on which the fair value of certain items has been determined. Micro-entities that wish or need to use fair value will still be able to do so by using other regimes under this Directive where a Member State permits or requires such use. This exclusion is not available to investment companies, financial holding companies and companies whose securities are traded on a regulated market.

Member States may, subject to certain disclosures, exempt micro entities from the obligation to: 1. draw up notes the accounts, 2. prepare an annual report or 3. publish annual accounts provided the balance sheet is filed with a designated competent authority, 4. recognise certain “prepayments and accrued income” and “accrual and deferred income”, 5. present “prepayments and accrued income” and “accrual and deferred income”. Member States may permit companies to draw up a greatly abridged balance sheet and P&L account. Abridged P&L account, here should be understood as income statement, is based on nature of expense classification. The nature of expense method has been chosen as a simple one to apply because no allocations of expenses to functional classifications are necessary. Moreover, the nature of expense method is useful in prediction future cash flows. Abridged profit & loss account for micro entities is illustrated in Tab.1.

Tab. 1: Abridged profit & loss account

A	Net turnover
B	Other income
C	Cost of raw materials and consumables
D	Staff costs
E	Value adjustments
F	Other charges
G	Tax

Source: Author’s own illustration

Member States may also permit companies to draw up only an abridged balance sheet showing separately at least those items preceded by letters in Articles 9 or 10 of the EC 4th Directive, where applicable. As for the layouts of the balance sheet, Member States may permit or require companies to adopt the presentation of the balance sheet set out in the Directive, either horizontal or vertical one as it is illustrated in tables bellow. Vertical layout of the balance sheet is in Tab. 2.

Tab. 2: Abridged Balance Sheet – Format 1

A	Called up share capital not paid
B	Fixed assets
C	Current assets
D	Prepayments and accrued income
E	Creditors: amounts falling due within one year
F	Net Current assets (liabilities)
G	Total assets less current liabilities
H	Creditors: amounts falling due after more than one year
I	Provisions for liabilities
J	Accruals and deferred income
K	Capital and reserves

Source: Author's own illustration

Vertical layout of the balance sheet is based on modified balance sheet equation, where assets minus liabilities equal to capital. Vertical layout of the balance sheet is in Tab. 3.

Tab. 3: Abridged Balance Sheet – Format 2

Assets	
A	Called up share capital not paid
B	Fixed assets
C	Current assets
D	Prepayments and accrued income
Liabilities	
A	Capital and reserves
B	Provisions for liabilities
C	Creditors
D	Accruals and deferred income

Source: Author's own illustration

As publication of annual accounts can be burdensome for micro-entities, Member States should be permitted to exempt micro-entities from a general publication requirement. This exemption is respected provided that balance sheet information is dully filed, in accordance with national law, with at least one designated competent authority and that the information is transmitted to the business register, so that a copy should be obtainable upon application.

Options are about presentation and notes. This relates to nature of business. Micro-entities have to provide mandatory notes concerning a) all commitments of any kind, if no obligation to be shown as liabilities, b) advances and credits, c) acquisitions of own shares.

At the same time, Member States need to ensure compliance with this Directive. Here is an important difference between the 4th EC Directive and “Micros directive” as companies can prepare abridged accounts.

Proposal for EC 4th and 7th Directives

Parallel to works on regulation for micro-entities, the EC began a series of consultations on revising the EC 4th and 7th Directive in order to simplify them for SMEs (EC, 2009b, 2009c). At the end of 2008, the European Parliament adopted a non-legislative resolution on accounting requirements as regards small and medium-sized companies, particularly micro-entities asking the Commission to continue its efforts to review those Directives.

The Commission Communication entitled "Single Market Act", adopted in April 2011, proposes to simplify EC 4th and 7th Directive as regards financial information obligations and to reduce administrative burdens. The European Council of 24 and 25 March 2011 also called for the overall regulatory burden, in particular for SMEs, to be reduced at both Union and national level and suggested measures to increase productivity and the improvement of the regulatory framework for SMEs.

The proposal for a Directive was issued on 25th October, 2011. Proposal takes the form of a new Directive repealing the 1978 and 1983 Directives and their subsequent amendments.

European Commission expects that setting up the thresholds for small companies relatively high and totally exempt small companies from an audit from an EU company law perspective would bring positive reaction that should be in compliance to reduce administrative burden.

Small, medium-sized and large undertakings are defined and distinguished by reference to total assets, turnover and the average number of employees, as these items typically provide objective evidence as to the size of an enterprise. The proposed Directive of 25th October, 2011 defines small undertakings as undertakings which on their balance sheet dates do not exceed the limits of two of the three following criteria: (a) balance sheet total: EUR 5 000 000; (b) net turnover: EUR 10 000 000; (c) average number of employees during the financial year: 50.

Medium-sized undertakings are undertakings which are not small ones and on their balance sheet dates do not exceed the limits of two of the three following criteria: (a) balance sheet total: EUR 20 000 000; (b) net turnover: EUR 40 000 000; (c) average number of employees during the financial year: 250. Large undertakings shall be undertakings which on their balance sheet dates exceed two of the three medium-sized undertakings criteria.

Limits for small groups, which shall be parent and subsidiary undertakings which on a consolidated basis do not exceed (a) balance sheet total: EUR 5 000 000; (b) net turnover: EUR 10 000 000; (c) average number of employees during the financial year: 50.

Limits for medium-sized groups shall be parent and subsidiary undertakings which are not small groups and on a consolidated basis do not exceed the limits of two of the three following criteria on the balance sheet date of the parent undertaking: (a) balance sheet total: EUR 20 000 000; (b) net turnover: EUR 40 000 000; (c) average number of employees during the financial year: 250. Large groups exceed two of three medium-sized undertakings criteria.

As a result of the "think small first" approach, small companies, in proposed Directive, were totally exempt from an audit from an EU company law perspective. On the other hand, proposal also specifies that public interest entities shall be subject to a statutory audit, regardless of their size. Proposed directive set the thresholds for small companies relatively high and totally exempt them from an audit commitment within an EU company law. European Commission expected positive reaction that should be in compliance to reduce administrative burden. It was exactly the opposite.

Setting up the thresholds for small companies in proposed Directive became the main topic of debates within Member States. Accounting profession, audit firms, auditors in many EU member states brought arguments against this proposal. At first, profession doesn´t want either to lose their position or opportunity to receive earnings from audit service. Secondly, profession argues that obligation to keep accounts is not sufficient argument for keeping accounts properly if audit is not followed. All other proposed improvements and commitments set up by the Commission became relatively less important to the EC member states and relatively better accepted in comparison with the audit requirements.

The European Commission recognises the central role played by SMEs in the Union economy and tried to bring simplification into financial reporting. The proposed Directive proposes only one balance sheet layout, whereas previously the Member States could choose between two different layouts. This would ensure better comparability of the financial statements from one jurisdiction to another in the EU. In addition, formation expenses are removed as a category of asset, as their recognition was dependent upon their being defined in Member States' law. A consequential amendment is necessary to the distributable profits test. A new requirement is introduced. The amount recognised in respect of a provision should correspond to the undertaking's best estimate of the liability or future expenditure. The "last in, first out", (LIFO) method of valuation as a permitted valuation method for stocks and fungible items is excluded. All changes would ensure better comparability of financial statements.

Only two profit and loss account layouts – one on a "by nature" basis, one on a "by function" basis are permitted, while previously four layouts were permitted. The objective here is to bring more comparability whilst retaining a presentation which will be familiar to financial statements' users. The previous distinction between ordinary and extraordinary items within the profit and loss account is removed, thereby countering an inherent bias which favoured the presentation of "large" or "unusual" items of expense as extraordinary, so as not to distort the headline profit after tax figure. Conversely there was an inherent bias to present "large" or "unusual" items of income as ordinary to bolster the headline profit figure. To ensure a neutral presentation of such items of income and expenditure there is a new requirement to disclose them separately within the profit and loss account, with an explanatory note. Therefore all such items will be recognised in arriving at profit after tax. Numerous Member State options existed around the note disclosures in the previous Directives. This approach has been replaced by a harmonised approach, which will mean that undertakings of the same size category throughout the EU will have the same or a comparable disclosure regime.

In the way of notes to the financial statements, a "bottom-up" approach to the provision of information is created here. Small undertakings will, overall, have a more limited disclosure regime, when compared to the previous Directives.

There are no substantive changes to the provisions governing the content of this report compared to those currently provided by the Fourth Council Directive 78/660/EEC and the Seventh Council Directive 83/349/EEC. No substantive changes to the publication provisions too.

New Directive

The thresholds for small companies in proposed Directive became the main topic of debates within Member States over last nearly two years. Full audit accounts supposed to provide true and fair view. New directive of June 26, 2013 repealing the 1978 and 1983 Directives and their subsequent amendments brought decreases in the size thresholds for small companies. The proposed Directive set for small undertakings higher thresholds: balance sheet total: EUR 5 000 000, net turnover: EUR 10 000 000.

Directive defines small undertakings as undertakings which on their balance sheet dates do not exceed the limits of two of the three following criteria:

a) balance sheet total: EUR 4 000 000;
b) net turnover: EUR 8 000 000;
c) average number of employees during the financial year: 50.

Member States shall ensure that the financial statements of public-interest entities, medium-sized and large undertakings are audited by one or more statutory auditors or audit firms approved by Member States to carry out statutory audits on the basis of Directive 2006/43/EC.

The annual financial statements shall comprise, as a minimum, the balance sheet, the profit and loss account and the notes to the financial statements. Member States may require accounting entities other than small ones to include other statements in the annual financial statements in addition to the balance sheet, the profit and loss account and the notes to the financial statements. 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 entities' 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.

As an exception from requirements for small companies, Member States may require small companies to prepare, disclose and publish information in the financial statements which goes beyond the requirements of the new Directive, provided that any such information is gathered under a single filing system and the disclosure requirement is contained in the national tax legislation for the strict purposes of tax collection. On the other hand, required information shall be included in the relevant part of the financial statements.

Impact of new directive on financial reporting in the Czech Republic

Since 1990, there has been a process of permanent rebuilding of regulatory accounting system in the Czech Republic as the role of accounting before 1990 was very distinct from the role of that in Western European countries.

The Czech regulatory accounting system since early ninetieth till 2002 is characterized as an accounting regulation without hierarchy, accounting regulation consisted of the Act only. Accounting is regulated by the Ministry of Finance that issued detailed Regulatory guidance for accounting which consisted of a Chart of accounts and Accounting procedures. Even though Regulatory guidance for accounting was not part of the Act, it became obligatory as it was strictly required by tax authorities in the Czech Republic (Žárová, 2008). In addition to financial statements prepared in compliance with the Act on Accounting, accounting units may also provide accounting information those are prepared in compliance with IFRS or other internationally recognized accounting principles.

Changes to the regulatory framework were completed as of January 1, 2004; three levels of accounting regulations have been in force since that date. Regulatory guidance for accounting was replaced by a new phenomenon in the Czech accounting, Czech Accounting Standards (CAS), which are prepared and issued by the Ministry of Finance exclusively.

Even after rebuilding the system of regulatory tools in the Czech Republic, accounting regulatory system remains state-regulated without any impact from the private-sector regulation. Regulation of accounting remains traditionally conducted by governmental institutions only and the position of professional independent accounting bodies is nil or very weak, even after introduction of accounting standards into the regulatory system (Žárová, 2006).

The year 2004 became crucial historical moment in the existence of the Czech Republic, also in accounting regulation. In May, 2004, the Czech Republic joined the European Union (EU). Adoption of the 2002 EU Regulation on the application of IFRS had fundamental effects on further development of accounting rules in the Czech Republic. Since joining the EU all listed companies shall prepare at least their consolidated financial statements in accordance with IASC standards by 2005 at the latest. The Accounting act dealing systematically with obligation to use of IFRS was issued firstly in the year 2004.

Since 2011, companies specified by the Act are allowed to select IFRSs as the basis for preparation of individual financial statements (parent companies preparing consolidated financial statements in compliance with the IFRS voluntarily, accounting entities under the control belonging to a consolidation group for which consolidating company prepares IFRS consolidated financial statements, joint ventures belonging to a consolidation group for which consolidating company prepares IFRS consolidated financial statements);(Žárová – Procházka – Roe, 2011).

Respecting legal and organizational aspect of division accounting entities, there are existing groups from companies to sole traders according to used rules in the Czech accounting system. First group covers large companies listed on capital market, their financial statements are audited. This group is obliged to use IFRS for keeping accounts and preparing financial statements. The second group of accounting entities keeping their accounts and prepare financial statements in compliance with Czech accounting standards. This group of accounting entities covers audited accounting entities as well as entities those haven't requirement to be audited. Entities in this group are not allowed to use IFRS either for keeping accounts or preparing financial statements. Third group covers small companies and sole traders. Even if the accounting entity is a company, these companies declared as small companies has not obligation to be audited and they are not allowed to use Czech accounting standards. They must keep accounts and prepare their financial statements in compliance with simplified double entry bookkeeping. Sole traders prepare cash based-bookkeeping primarily for the tax purposes.

Comparison of balance sheet according to new Directive and Czech regulations

The proposed Directive proposed only one balance sheet layout, whereas previously the Member States could choose between two different layouts. This would ensure better comparability of the financial statements from one jurisdiction to another in the EU. On the other hand, the new Directive enlarged variety of choice in balance sheet layouts; horizontal and vertical one as basic ones or any layout of balance sheet on the basis of a distinction between current and non-current items. In addition, formation expenses are removed as a category of asset, as their recognition was dependent upon their being defined in Member States' law.

Directive indicates the items that shall be shown in the balance sheet separately as well as the order of items. It is said that more detailed subdivision of items prescribed in layouts are permitted and addition of subtotals and of new items those are not covered by any of the items in the prescribed layouts. Here is no indicator as for relevance of items.

Following tables bring comparison of line items in balance sheet determined by the new Directive with present reporting requirements set up by the Czech regulatory rules. The items prescribed by the Directive are indicated in tables in the left column, right column represents balance sheet items in current Czech statements. As the accounting entities in the Czech Republic traditionally prepare balance sheet in horizontal layout, only one comparison is done based on horizontal layout in tables bellow. Tab. 4 illustrates comparison of items in non-current assets subdivision of balance sheet.

Tab. 4: Subdivision of non-current assets

	EC Directive	Czech accounting law
	Non-current Assets	
A.	Subscribed capital unpaid of which there has been called[5]	✓

[5] Unless national law provides that called-up capital is to be shown under 'Capital and reserves', in which case the part of the capital called but not yet paid shall appear as an asset either under A or under D (II) (5)

	EC Directive	Czech accounting law
B.	Formation expenses[6]	✓
C.	Fixed assets I. Intangible assets	✓
	1. Costs of development	✓
	2. Concessions, patents, licenses, trademarks and similar rights and assets, if they were: a) acquired for valuable consideration and need not be shown under C (I) (3); or b) created by the undertaking itself, in so far as national law permits their being shown as assets	Separate lines for: – software – similar rights and assets
	3. Goodwill, to the extent that it was acquired for valuable consideration.	✓
	4. Payments on account	✓
	II. Tangible assets	✓
	1. Land and buildings.	✓
	2. Plant and machinery	✓
	3. Other fixtures and fittings, tools and equipment	Separate lines for: – Individual movable assets – perennial crops – animals – other tangible assets
	4. Payments on account and tangible assets in the course of construction	Line No.4 in two separate lines
	No equivalent to CZ	Valuation difference relation to acquired assets
	III. Financial assets	✓
	1. Shares in affiliated undertakings	✓
	2. Loans to affiliated undertakings	✓
	3. Participating interests	✓

[6] As defined by national law, and in so far as national law permits their being shown as an asset. National law may also provide for formation expenses to be shown as the first item under 'Intangible assets'

	EC Directive	Czech accounting law
	4. Loans to undertakings with which the undertaking is linked by virtue of participating interests	✓
	5. Investments held as fixed assets	No equivalent in CZ
	6. Other loans	✓
	7. No equivalent to CZ	Long-term investment – being acquired
	8. No equivalent to CZ	Advance payment for long-term investment

Source: Author´s own illustration

Whether particular assets are to be shown as fixed assets or current assets shall depend upon the purpose for which they are intended. Directive hasn´t provide more detailed indicators to recognise current and fixed assets. Tab. 5 brings comparison of items in current assets subdivision.

Tab. 5: Subdivision of currents assets

	EC Directive	Czech accounting law
D.	Current assets	
	I. Stocks	✓
	1. Raw materials and consumables	✓
	2. Work in progress	✓
	3. Finished goods and goods for resale	Line No. 3 in two separate lines
	4. No equivalent to CZ	Breeding animals and other kinds of animals (groups)
	5. Payments on account	✓
	II. Debtors[7]	Amounts becoming due after more than one year are shown separately for each item
	1. Trade debtors	✓
	2. Amounts owed by affiliated undertakings	✓

[7] Amounts becoming due and payable after more than one year shall be shown **separately** for each item.

	EC Directive	Czech accounting law
	3. Amounts owed by undertakings with which the undertaking is linked by virtue of participating interests	✓
	4. Other debtors	✓
	5. No equivalent to CZ	Long-term advance payment
	6. No equivalent to CZ	Contingent assets – Long-term asset
	7. No equivalent to CZ	Deferred taxes – Long-term asset
	8. No equivalent to CZ	Long-term advance payment
	9. Subscribed capital called but not paid[8]	Asset under A
	10. Prepayments and accrued income[9]	Assets under E
	11. No equivalent to CZ	Social security and health insurance
	12. No equivalent to CZ	Due from state- tax receivables
	13. No equivalent to CZ	Short-term advance payment
	14. No equivalent to CZ	Short-term contingencies
	III. Investments	✓
	1. Shares in affiliated undertakings	✓
	2. Own shares (to the extent that national law permits their being shown in the balance sheet.)	Not permitted
	3. Other investments	Short-term financial assets – being acquired
	IV. Cash at bank and in hand	✓
E.	Prepayments and accrued income[10]	✓
	No equivalent to CZ	Deferred expenses (different types)

Source: Author´s own illustration

[8] Unless national law provides that called-up capital is to be shown as an asset under A.
[9] Unless national law provides that such items are to be shown as assets under E.
[10] Unless national law provides that such items are to be shown as assets under D (II) (6).

An entity shall present current and fixed assets as separate classifications in its balance sheet. Tab. 6 describes comparison in subdivision of capital and reserves.

Tab. 6: Subdivision of capital and reserves

	EC Directive	Czech accounting law
	Capital, reserves and liabilities	
A.	Capital and reserves	✓
	I. Subscribed capital[11]	Registered capital Own shares (-) Own ownership interest (-) Changes in registered capital
	II. Share premium account	✓
	III. Revaluation reserve	Gains and losses from revaluation on assets Gains and losses from revaluation on business combination
	IV. Reserves	✓
	1. Legal reserve[12]	✓
	2. Reserve for own shares[13]	Not required as a reserve
	3. Reserves provided for by the articles of association.	✓
	4. Other reserves, including the fair value reserve.	✓
	5. No equivalent to CZ	Retained earnings from previous years
	4. Profit or loss brought forward	✓
	5. Profit or loss for the financial year	✓

Source: Author´s own illustration

[11] Unless national law provides that called-up capital is to be shown under this item, in which case the amounts of subscribed capital and paid-up capital shall be shown separately.
[12] In so far as national law requires such a reserve.
[13] In so far as national law requires such a reserve, without prejudice to point (b) of Article 24(1) of Directive 2012/30/EU.

Tab. 7 shows subdivision of provisions and creditors, amounts which are payable within one year or amounts payable after more than one year.

Tab. 7: Subdivision of provisions and creditors

	EC Directive	Czech accounting law
B.	Provisions	
	1. Provisions for pensions and similar obligations	✓
	2. Provisions for taxation	✓
	3. Other provisions	✓
C.	Creditors[14]	Amounts payable after more than one year are shown separately for each item
	1. Debenture loans[15]	✓
	2. Amounts owed to credit institutions	✓
	3. Payments received on account of orders[16]	✓
	4. Trade creditors.	✓
	5. Bills of exchange payable	✓
	6. Amounts owed to affiliated undertakings	✓
	7. Amounts owed to undertakings with which the undertaking is linked by virtue of participating interests	✓
	8. Other creditors, including tax and social security authorities	✓
	9. Accruals and deferred income [17]	Liability under D
	10. No equivalent to CZ	Short-term and long-term contingencies
	11. No equivalent to CZ	Short-term advances received

[14] Amounts becoming due and payable within one year and amounts becoming due and payable after more than one year shall be shown separately for each item and for the aggregate of those items.
[15] Convertible loans showing separately.
[16] In so far as they are not shown separately as deductions from stocks.
[17] Unless national law provides that such items are to be shown under D.

	EC Directive	Czech accounting law
D.	Accruals and deferred income[18]	✓

Source: Author´s own illustration

Member States may permit or require undertakings, or certain classes of undertaking, to present items on the basis of a distinction between current and non-current items in a different layout from that set out in the Directive and the table above. Different layout is allowed provided that the information given is at least equivalent to that in the standard layouts illustrated in the Directive.

Comparison of profit and loss account according to new Directive and Czech regulations

New Directive permits a profit and loss account layout showing the nature of expenses and a profit and loss account layout showing the function of expenses, both in report form. Directive set out items in the profit and loss account and requires to be shown separately in the order the Directive indicates. For the presentation of the profit and loss account, Member States shall prescribe one or both of the layouts set out in Directive. If a Member State prescribes both layouts, it may permit accounting entities to choose which of the prescribed layouts to adopt. Despite the fact that a statement of performance has been introduced into Directives in 2003, namely Directive 2003/51/EC, only the new Directive allows accounting entities to present a statement of performance instead of a profit and loss account prepared in accordance with one of the permitted layouts.

Fundamental change in presentation of profit and loss account concerns items as extraordinary revenues, extraordinary expenses and income of these items. Extraordinary items are not allowed to be recognised either in accounting books or in statements.

The Czech accounting system, till 2003, permits accounting entities to prepare a profit and loss account statement showing the nature of expenses. Rule was rigid even in cases where the characteristics of business would allow the function of expenses method. Tab. 8 includes comparison of items in the profit and loss account layout showing the nature of expenses in Directive and in the Czech accounting system.

[18] Unless national law provides that such items are to be shown under C (9) under “Creditors”.

Tab. 8: Profit and loss account – by nature of expense

	EC Directive	Czech accounting law
1.	Net turnover	Separately recognised revenues from selling goods, products, services
2.	Variation in stocks of finished goods and in work in progress	✓
3.	Work performed by the undertaking for its own purposes and capitalised	✓
4.	Other operating income	✓
5.	(a) Raw materials and consumables	✓
	(b) Other external expenses	✓
6.	Staff costs:	✓
	(a) wages and salaries	✓
	(b) social security costs, with a separate indication of those relating to pensions	✓
7.	(a) Value adjustments in respect of formation expenses and of tangible and intangible fixed assets	
	(b) Value adjustments in respect of current assets, to the extent that they exceed the amount of value adjustments which are normal in the undertaking concerned	
8.	Other operating expenses	
9.	Income from participating interests, with a separate indication of that derived from affiliated undertakings	
10.	Income from other investments and loans forming part of the fixed assets, with a separate indication of that derived from affiliated undertakings	
11.	Other interest receivable and similar income, with a separate indication of that derived from affiliated undertakings	
12.	Value adjustments in respect of financial assets and of investments held as current assets	

	EC Directive	Czech accounting law
13.	Interest payable and similar expenses, with a separate indication of amounts payable to affiliated undertakings	
14.	Tax on profit or loss	✓
15.	Profit or loss after taxation	✓
		Extraordinary revenues
		Extraordinary expenses
		Income tax on extraordinary activities
16.	Other taxes not shown under items 1 to 15	
17.	Profit or loss for the financial year	✓

Source: Author´s own illustration

It is evident from the comparison of profit and loss account in the new Directive and statement in Czech accounting system, that except extraordinary revenues and extraordinary expenses, no other differences are recognised. Unlike the Directive, Czech profit and loss account recognises some items in more detail. The group of accounts entitled Personal expenses includes information on remuneration of board members. Information on taxes and fees is a separate line in profit and loss account. “Gains from sales of fixed assets and materials”, “Net book value of fixed assets and materials sold” and “Change in provisions and allowance for operating expenses” are subgroup titles of items presented separately in Czech profit and loss account that haven´t any equivalent in the Directive.

Profit and loss statement showing the function of expense has been transposed into the Czech legislation concerning accounting only in 2003. As profit and loss account based on classification of function of expense hasn’t been a traditional approach of expense recognition, this layout was transposed into the Czech accounting system without derivatives from the original Directive. That’s the reason of nil differences in comparison Czech approach with that one from the Directive. Comparative overview is illustrated in the Tab. 9.

Tab. 9: Profit and loss account – by function of expense

	EC Directive	**Czech accounting law**
1.	Net turnover	✓
2.	Cost of sales (including value adjustments)	✓
3.	Gross profit or loss	✓
4.	Distribution costs (including value adjustments)	✓
5.	Administrative expenses (including value adjustments)	✓
6.	Other operating income	✓
7.	Income from participating interests, with a separate indication of that derived from affiliated undertakings	✓
8.	Income from other investments and loans forming part of the fixed assets, with a separate indication of that derived from affiliated undertakings	✓
9.	Other interest receivable and similar income, with a separate indication of that derived from affiliated undertakings	✓
10.	Value adjustments in respect of financial assets and of investments held as current assets	✓
11.	Interest payable and similar expenses, with a separate indication of amounts payable to affiliated undertakings	✓
12.	Tax on profit or loss	✓
13.	Profit or loss after taxation	✓
14.		Extraordinary revenues
15.		Extraordinary expenses
16.		Income tax on extraordinary activities
17.	Other taxes not shown under items 1 to 13	Other taxes in line 16.
18.	Profit or loss for the financial year	✓

Source: Author´s own illustration

Comparison of profit and loss account in the new Directive and statement in the Czech accounting system illustrates that except extraordinary revenues and extraordinary expenses, no other differences are recognised.

Conclusion

Modernisation of the EC 4th Directive that has been in force since 1978 and the EC 7th Directive has been awaited for rather long period. Serious works on modernization of crucial accounting European Directives has been conducted since 2008. European accounting systems are mostly influenced by IFRS. This trend is on one hand very natural and very useful as for increasing reliability of accounting information provided by financial statements prepared in compliance with domestic rules where European Directives are transposed. On the other hand European accounting systems suffer from partial implementation of IFRS into legislation of Member States. IFRS partial implementation may even cause breakdown of the accounting system or may bring entities to the court; moreover entities spent higher costs and may lose confidence by users of accounting information (Žárová – Mejzlík, 2009).

This trend has been confirmed by series of consultations on Directives with preparers and users of financial statements, with public authorities have shown that the content of Directives broadly reflects the current framework. There can be seen room for simplification, especially to benefit the smallest companies. Amendments to the Directives, done during last 30 years, have added many requirements, such as new disclosures and valuation rules, including detailed provisions on fair value accounting, but less attention has been paid to considering whether existing requirements could be simplified or removed. The output of works on the Directives was the proposal of 25th October, 2011 repealing the 1978 and 1983 Directives and their subsequent amendments. The thresholds for small companies in proposed Directive became the main topic of debates within Member States as small companies are excluded from the requirement to audit their financial statements. New Directive was issued on June 23, 2013.

This article deals, on the background of conceptual changes in EC Directives for accounting, with the impact of new accounting Directive on presentation of balance sheet and profit and loss account by companies regulated by local European accounting rules. Study is prepared in the Czech Republic. Comparative analysis brings the main findings that there are not substantial differences between current financial statements used in the Czech Republic and required statements in the new EC Directive for accounting, except for the deletion of extraordinary expenses and extraordinary revenue. Other question is that the new Directive requires follow strictly substance over form principle. This seems to be a stumbling block in the Czech accounting conceptual framework.

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Changes in EC Directives and Impact on Presentation of Financial Statements in the Czech Republic

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ABSTRACT

The EC 4th Directive has been in force since 1978, at least till 2001 without fundamental changes. Nearly the same history concerns the EC 7th Directive, firstly issued in 1983. Then new requirements, such as new disclosures and valuation rules, including provisions on fair value accounting, have been added. Less attention has been paid to considering whether existing requirements could be simplified or removed. Research studies confirm that amendments have tended to ignore the comparability and usefulness of the financial statements, increased reporting requirements and the number of Member State options. All these facts have ultimately, in the long run, led to increased complexity and regulatory burden for all companies. European Commission proposed to simplify the 4th and 7th Council Directives as regards financial information obligations and to reduce administrative burdens, in particular for SMEs. This article investigates impact of new Directives´ financial reporting requirements on presentation of financial statements of companies those use local regulatory rules, which should comply with the Directive of June 26, 2013 repealing the 1978 and 1983 Directives and their subsequent amendments, in the Czech Republic.

Conclusion from this article might be useful for practice as for the potential future changes in presentation of financial statements or researchers who find out similarities or differences between European accounting systems.

Key words: EC 4th Directive; EC 7th Directive; Administrative burdens; Presentation of financial statements.

JEL classification: M41.