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ACCA STATEMENT ON THE EU DECISION ON MICRO COMPANIES

The Association of Chartered Certified Accountants (ACCA) is disappointed at the European Commission's decision to push for the abolition of the legal requirement for 'micro companies' to prepare and publish annual accounts on the grounds that it risks depriving stakeholders of information about companies' financial status and undermining confidence in the financial viability of the small business sector.

At present, EU law requires that all limited liability companies, of which there are some 2.5 million in the UK, prepare and publish annual financial statements in accordance with prescribed disclosure rules. Companies which are defined as 'small' – the main defining parameters of which are turnover of up to £6.6 million and fewer than 50 staff – benefit from substantial derogations as to the amount of information they must disclose. The EU has now decided that individual member states will be able to exempt a new category of 'micro' company – those with turnover of up to €1 million euros and fewer than 10 staff - from compliance with these provisions of EU law. It is estimated that some 6 million companies across the EU will be affected by this relaxation of the law.

In allowing member states to set their own accounting rules for the micro company, or even to exempt them from such requirements altogether, the Commission's decision opens up the prospect of a proliferation of accounting regimes within the EU which will create uncertainty about stakeholder rights at the same time as the EU is legislating for the standardisation of such rights in the context of larger companies and encouraging SMEs to conduct more cross-border trade.

The background to the EU's announcement is a drive to reduce administrative burdens for SMEs. This is a goal which ACCA fully supports: as a matter of principle, regulatory burdens should only be imposed on businesses where their wider benefits exceed the cost of compliance. Where there is no net regulatory benefit, there should be no regulatory burden. In this particular case, however, ACCA feels that the EU's concern to reduce the direct financial costs of compliance has failed to pay adequate attention to the compensating regulatory benefits of the rules on accounting and reporting. Crucially, the decision does not pay due regard to the fact that the essential purpose of these rules is to protect the interests of the company's stakeholders - this means not solely their shareholders, the state and the tax authorities but, more indirectly, companies'

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employees, creditors and prospective trading partners. Without access to credible accounting information, prepared in accordance with uniform technical rules, the ability of stakeholders to protect their financial interests will be necessarily decreased.

ACCA's reaction to the EU's decision is based on the following arguments:

(i) The cost savings that are likely to stem from the decision are exaggerated and will be difficult to achieve in practice. The research to which the EU referred in coming to its conclusion suggested that the average accounting cost which micro companies currently incurred, and which might in future be saved, was in the region of €1,200 pa. ACCA disputes that accounting preparation costs for businesses in the target range are likely to be as high. The EU's projected cost saving also assumes that no accounting costs will be incurred in place of the abolished company law rules. But annual accounts prepared on a 'true and fair' basis – which take into account both legal rules and applicable technical standards – currently form the basis for computations of a company's tax liability. If, as seems more than probable, the tax authorities in the various EU countries choose to insist that companies continue to prepare accounts for tax purposes on a similar or approximate basis in future, then companies will continue to incur accounting costs. Companies will also be expected to prepare credible accounting information for presentation on an *ad hoc* basis to banks, public authorities and other potential lenders of finance. Accordingly, the mere act of abolishing company law requirements to produce annual accounts will not of itself do away with accounting costs.

(ii) All limited liability businesses have a fundamental duty of accountability to their shareholders. Uniform rules on financial reporting are key to enabling shareholders – especially non-director shareholders – to monitor how the company's funds are being used and how the directors are carrying out their responsibilities. Without a legal requirement for financial statements to be prepared in the first place there can be no consequent entitlement for shareholders and lenders routinely to receive those statements, and the potential for internal disputes in small private companies would be materially increased. But it is not just shareholders who have a stake in the provision by companies of credible accounting information. Employees and creditors of the business are able to monitor the financial health of the business for their own purposes and

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prospective business partners are currently able to review a company's accounts on the public record, on a confidential basis, before deciding whether to do business with it. These protections would be lost if micro companies were not required to prepare and publish annual accounts.

(iii) In seeking to reduce unnecessary administrative burdens for very small businesses, the EU has chosen not to promote what we see as an obvious and logical course of action, namely to encourage businesses to operate as unincorporated bodies and to remove regulatory obstacles to the process of disincorporation. All businesses have the choice to operate either as corporate or unincorporated bodies. If a very small business is not prepared to subject itself to what is currently a very modest level of company law regulation, it is quite free to trade as a sole trader or partnership. The fact that so many very small businesses choose to incorporate suggests that such businesses do not consider the current level of regulation, and its associated cost, to be a deterrent to the adoption and retention of corporate status. Accordingly, rather than reduce the scope of corporate regulation to a level which compromises fundamental company law safeguards, ACCA believes that the focus of de-regulatory action should be on encouraging very small businesses to trade via a format which is probably more appropriate to their character.

(iv) ACCA is concerned about the message which this de-regulation of accounting controls may give to businesses about financial crime, especially given the increasing concerns over the incidence of fraud, bribery and money laundering in the recession. In recent years, practising accountants have become one of the key gate-keepers in the fight against financial crime. In addition to their professional responsibilities, accountants throughout the EU now have legal responsibilities to report to their home state authorities any knowledge or suspicion they acquire which suggests that a person they deal with in the course of their business is laundering the proceeds of crime. If the consequence of the EU's move is that small companies in future are free to operate without the necessary input of an independent qualified accountant, this could substantially weaken the EU's framework of controls over financial crime.

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We believe that each of these issues need to be addressed seriously before any final decision is made on the future of the Directive.

ACCA will continue to argue that companies should continue to be subject to rules which impose reasonable internal control demands on directors and appropriate safeguards for the stakeholders that they deal with, both within and outside the company. This should be seen as a fair price to pay for the limitation of personal liability which the company format offers to business owners.

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