

EUROPEAN PARLIAMENT

2004



2009

Committee on Legal Affairs

PROVISIONAL
2004/0250(COD)

3.5.2005

*****I**

DRAFT REPORT

on the proposal for a directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC concerning the annual accounts of certain types of companies and consolidated accounts (COM(2004)0725 – C6-0164/2004 – 2004/0250(COD))

Committee on Legal Affairs

Rapporteur: Klaus-Heiner Lehne

Symbols for procedures

- * Consultation procedure
majority of the votes cast
- **I Cooperation procedure (first reading)
majority of the votes cast
- **II Cooperation procedure (second reading)
*majority of the votes cast, to approve the common position
majority of Parliament's component Members, to reject or amend
the common position*
- *** Assent procedure
*majority of Parliament's component Members except in cases
covered by Articles 105, 107, 161 and 300 of the EC Treaty and
Article 7 of the EU Treaty*
- ***I Codecision procedure (first reading)
majority of the votes cast
- ***II Codecision procedure (second reading)
*majority of the votes cast, to approve the common position
majority of Parliament's component Members, to reject or amend
the common position*
- ***III Codecision procedure (third reading)
majority of the votes cast, to approve the joint text

(The type of procedure depends on the legal basis proposed by the Commission)

Amendments to a legislative text

In amendments by Parliament, amended text is highlighted in ***bold italics***. Highlighting in *normal italics* is an indication for the relevant departments showing parts of the legislative text for which a correction is proposed, to assist preparation of the final text (for instance, obvious errors or omissions in a given language version). These suggested corrections are subject to the agreement of the departments concerned.

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DRAFT EUROPEAN PARLIAMENT LEGISLATIVE RESOLUTION

on the proposal for a directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC concerning the annual accounts of certain types of companies and consolidated accounts (COM(2004)0725 – C6-0164/2004 – 2004/0250(COD))

(Codecision procedure: first reading)

The European Parliament,

- having regard to the Commission proposal to the European Parliament and the Council (COM(2004)0725)¹,
 - having regard to Article 251(2) and Article 44(1) of the EC Treaty, pursuant to which the Commission submitted the proposal to Parliament (C6-0164/2004),
 - having regard to Rule 51 of its Rules of Procedure,
 - having regard to the report of the Committee on Legal Affairs and the opinion of the Committee on Economic and Monetary Affairs (A6-0000/2005),
1. Approves the Commission proposal as amended;
 2. Calls on the Commission to refer the matter to Parliament again if it intends to amend the proposal substantially or replace it with another text;
 3. Instructs its President to forward its position to the Council and Commission.

Text proposed by the Commission

Amendments by Parliament

Amendment 1
RECITAL 9 A (NEW)

(9a) Responsibility and liability are separate. Responsibility need not automatically entail liability. Responsibility and liability are derived from national law. In particular, national liability rules may provide for the possibility of exemption from blame.

Justification

This recital seeks to clarify Article 1(3) and Article 2(1).

¹ OJ C ..., ..., p.

Amendment 2
ARTICLE 1, PARAGRAPH 1
Article 43, paragraph 1, point 7a (Directive 78/660/EEC)

(7a) the nature and business purpose of company's arrangements not included in the balance sheet, and the financial impact on the company of those arrangements, in so far as the information set out is material and of assistance in assessing the financial position of the company" ***deleted***

Justification

The proposed inclusion of off-balance sheet transactions in the notes is not necessary. The rules of IAS 1, Presentation of Financial Statements, ensures that sufficient information relevant to decision-making is disclosed. There is also no need to treat listed and non-listed companies in the same way. In the absence of a "public interest" it is neither relevant nor necessary to broaden the scope of the disclosure requirements.

Amendment 3
ARTICLE 1, PARAGRAPH 1
Article 43, paragraph 1, point 7b (Directive 78/660/EEC)

(7b) the nature, business purpose and amount of any transaction entered into by the company with related parties, where that transaction is material and has not been concluded under normal commercial conditions. The definitions of related party set out in paragraph 3 of the International Accounting Standard 24 on Related Party Disclosures as set out in Commission Regulation (EC) 1725/2003¹ shall apply for the purposes of this Directive." ***deleted***

Justification

Provisions which go beyond or diverge from IRFS/IAS 24 on the disclosure of transactions with related parties should be rejected. In many cases it will not be possible in practice to apply the criterion of "normal commercial conditions" in the absence of a basis for comparison. Listed companies [should not be] treated in the same way as non-listed companies.

¹ OJ L 261, 13.10.2003, p. 1

Amendment 4
ARTICLE 1, PARAGRAPH 2
Article 46a, paragraph 1, opening clause (Directive 78/660/EEC)

A company whose *securities* are admitted to trading on a regulated market, within the meaning of Article 4(1)(14) of Directive 2004/39/EC of the European Parliament and of the Council shall **include** a corporate governance statement **in its annual report**. That statement **shall be included as a separate part of the annual report and** shall contain at least the following information:

A company whose *shares* are admitted to trading on a regulated market, within the meaning of Article 4(1)(14) of Directive 2004/39/EC of the European Parliament and of the Council shall **make** a corporate governance statement **permanently accessible as a separate legal instrument**. That statement shall contain at least the following information:

Justification

The corporate governance statement should not form part of the annual report, because this would entail a management assessment.

Amendment 5
ARTICLE 1, PARAGRAPH 2
Article 46a, paragraph 1, point 2 (Directive 78/660/EEC)

2. an explanation as to whether and to which extent **the company complies with** the corporate governance code referred to under point (1).

2. an explanation as to whether and to which extent the corporate governance code referred to under point (1) **has been or is being complied with**.

Justification

The change of wording makes clear that the explanation also relates to the past.

Amendment 6
ARTICLE 1, PARAGRAPH 2
Article 46a, paragraph 1, point 3 (Directive 78/660/EEC)

3. a description of the company's internal control and risk management systems; ~~deleted~~

Justification

The notion of internal control and risk management systems is insufficiently specific and

overlaps with risk reporting pursuant to Directive 2003/51/EC. The benefit of including this in the corporate governance statement is not commensurate with the cost it would involve.

Amendment 7
ARTICLE 1, PARAGRAPH 2
Article 46a, paragraph 1, point 4 (Directive 78/660/EEC)

4. the information required by Article 10, paragraph 1, points (c), (d), (f), (h), and (i) of Directive 2004/25/EC of the European Parliament and of the Council; ***deleted***

Justification

The information requirement which already exists under the Takeovers Directive should not also be incorporated into the corporate governance statement as well. This would not have any added value for shareholders and would merely increase costs.

Amendment 8
ARTICLE 1, PARAGRAPH 2
Article 46a, paragraph 1, point 5 (Directive 78/660/EEC)

5. the operation of the shareholder meeting and its key powers, and a description of shareholder's rights and how they can be exercised; ***deleted***

Justification

This information is governed by the relevant national laws and codes and does not need to be repeated here.

Amendment 9
ARTICLE 1, PARAGRAPH 2
Article 46a, paragraph 1, point 6 (Directive 78/660/EEC)

6. the composition and operation of the board and its committees. ***deleted***

Justification

This information is governed by the relevant national laws and codes and does not need to be repeated here.

Amendment 10
ARTICLE 1, PARAGRAPH 2
Article 46a, paragraph 2 (Directive 78/660/EEC)

To the extent a company departs from the ~~deleted~~ corporate governance code referred to under point (1), the company shall explain from which parts of the code it departs and the reasons for doing so.

Justification

This information is partly already covered by point 2. In any case it should be for the national Code Commission to determine what tasks they consider should be required. Answering the question why recommendations of the corporate governance code have not been complied with should be left to the company. The European legislator should not interfere with the standard-setting power of the national codes merely in order to obtain the advantage of a flexible market reaction.

Amendment 11
ARTICLE 1, PARAGRAPH 3
Article 50b (Directive 78/660/EEC)

Member States shall ensure that the members of the administrative, management and supervisory bodies of the company are collectively responsible towards the company for ensuring that the annual accounts and the annual report are drawn up and published in accordance with the requirements of this Directive.

Member States shall ensure that the members of the administrative, management and supervisory bodies of the company are collectively responsible, ***together with the other members of the same body each within its own sphere of responsibility***, towards the company ***under the relevant national law*** for ensuring that the annual accounts and the annual report are drawn up and published in accordance with the requirements of this Directive.

Justification

It needs to be made clear that, under this dual system, there is no joint and several liability in the relationship between the two bodies. The duties of management on the one hand and supervisory authority on the other are fundamentally different.

Amendment 12
ARTICLE 1, PARAGRAPH 4
Article 60a (Directive 78/660/EEC)

”Without prejudice to Article 6 of Directive 68/151/EEC and to the right of Member States to impose criminal sanctions, the Member States shall lay down the *rules on penalties* applicable to infringements of the national provisions adopted pursuant to this Directive **and shall take all measures necessary to ensure that they are implemented. The *penalties and measures* provided for must be effective, proportionate and dissuasive. The Member States shall notify those provisions to the Commission by 31 December **2006** at the latest and shall notify it without delay of any subsequent amendment affecting them.”**

”The Member States shall lay down the **sanctions** applicable to infringements of the national provisions adopted pursuant to this Directive. The **sanctions** provided for must be effective, proportionate and dissuasive. The Member States shall notify those provisions to the Commission by 31 December **2007** at the latest and shall notify it without delay of any subsequent amendment affecting them.”

Justification

Simplification based on the terminology of the ECJ.

Amendment 13
ARTICLE 2, PARAGRAPH 1
Article 34, point 7a (Directive 83/349/EEC)

“(7a) the nature and business purpose of any arrangements not included in the consolidated balance sheet, and the financial impact of those arrangements, in so far as the information set out is of direct relevance and assistance in assessing the financial position of the undertakings included in the consolidation taken as a whole.” **deleted**

Justification

See Justification to Article 1(1). The proposed inclusion of off-balance sheet transactions in the notes is not necessary. The rules of IAS 1, Presentation of Financial Statements, ensures that sufficient information relevant to decision-making is disclosed. There is also no need to treat listed and non-listed companies in the same way. In the absence of a “public interest” it is neither relevant nor necessary to broaden the scope of the disclosure requirements.

Amendment 14
ARTICLE 2, PARAGRAPH 1
Article 34, point 7b (Directive 83/349/EEC)

“(7b) the nature, business purpose and amount of any transaction entered into by the parent undertaking, or by other undertakings included in the consolidation, with related parties, where that transaction is material and has not been under normal commercial conditions.”

deleted

Justification

See Justification to Article 1(1). The proposed inclusion of off-balance sheet transactions in the notes is not necessary. The rules of IAS 1, Presentation of Financial Statements, ensures that sufficient information relevant to decision-making is disclosed. There is also no need to treat listed and non-listed companies in the same way. In the absence of a “public interest” it is neither relevant nor necessary to broaden the scope of the disclosure requirements.

Amendment 15
ARTICLE 2, PARAGRAPH 3
Article 36a (Directive 83/349/EEC)

Member States shall ensure that the members of the administrative, management and supervisory bodies of the undertaking drawing up the consolidated accounts and the consolidated annual report are collectively responsible towards that undertaking for ensuring that the consolidated annual accounts and the consolidated annual report are drawn up and published in accordance with the requirements of this Directive.

Member States shall ensure that the members of the administrative, management and supervisory bodies of the undertaking drawing up the consolidated accounts and the consolidated annual report are collectively responsible, ***together with the other members of the same body each within its own sphere of responsibility***, towards that undertaking ***under the relevant national law*** for ensuring that the consolidated annual accounts and the consolidated annual report are drawn up and published in accordance with the requirements of this Directive.

Justification

See Justification to Amendment to Article 50b: It needs to be made clear that, under this dual system, there is no joint and several liability in the relationship between the two bodies. The duties of management on the one hand and supervisory authority on the other are fundamentally different.

Amendment 16
ARTICLE 2, PARAGRAPH 5
Article 48 (Directive 83/349/EEC)

*Without prejudice to Article 6 of Directive 68/151/EEC and to the right of Member States to impose criminal sanctions the Member States shall lay down the **rules on penalties** applicable to infringements of the national provisions adopted pursuant to this Directive **and shall take all measures necessary to ensure that they are implemented**. The **penalties** provided for must be effective, proportionate and dissuasive. The Member States shall notify those provisions to the Commission by 31 December **2006** at the latest and shall notify it without delay of any subsequent amendment affecting them.”*

*The Member States shall lay down the **sanctions** applicable to infringements of the national provisions adopted pursuant to this Directive. The **sanctions** provided for must be effective, proportionate and dissuasive. The Member States shall notify those provisions to the Commission by 31 December **2007** at the latest and shall notify it without delay of any subsequent amendment affecting them.”*

Justification

Simplification based on the terminology of the EJC.

EXPLANATORY STATEMENT

The Commission proposal

This proposal for a Commission directive seeks, by amending the accounting directives 77/660/EEC on the annual accounts of certain types of companies (4th Company Law Directive) and 83/349/EEC on consolidated accounts (7th Company Law Directive), to further enhance confidence in the financial statements and annual reports published by European companies and ensure that shareholders and other stakeholders obtain reliable, complete and easily accessible information.

As already announced in its Action Plan on Company Law and Corporate Governance of 21 March 2003, the Commission proposes to amend and supplement the accounting directives on the following points:

- Enhancing transparency about off-balance arrangements:

To ensure that all companies – whether listed on the stock exchange or not – are required to disclose off-balance sheet transactions and their financial impact where these may be crucial to an investor's assessment of a company's financial situation, the proposal for a Directive provides that additional specific information on material off-balance sheet arrangements should be disclosed in the notes to the annual and consolidated accounts. Accordingly the Commission proposes to add a new subparagraph to Article 43 (1) of Directive 78/660/EEC and in Article 2 the Commission proposes to add a new subparagraph to Article 34 of Directive 83/349/EEC.

- Enhancing transparency about related parties' transactions:

Under the proposal for a directive, in future transactions with related parties are to be disclosed where they are material and are not carried out under normal commercial conditions. In order to determine who is a related party, the Commission proposes to integrate the definitions set out in IAS 24, as endorsed under the IAS-Regulation¹. Accordingly, the Commission proposes in Article 1 to add a new subparagraph to Article 43 (1) of Directive 78/660/EEC and in Article 2 to add a new subparagraph to Article 34 of Directive 83/349/EEC. In Article 2 the Commission also proposes to add a new paragraph 1a to Article 41 of Directive 83/349/EEC.

- Establishing collective responsibility of board members:

The Commission proposes that the accounting directives should include supplementary provisions on the collective responsibility of board members towards the company in respect of annual reports and financial statements. Accordingly, the Commission proposes in Article 1 to insert a new section containing Articles 50b and 60a in Directive 78/660/EEC and in Article 2 to insert a new section containing Article 36(a) in Directive 83/349/EEC and

¹ OJ L 243, 11.9.2002, p. 1.

inserting Article 48 under section 6 of Directive 83/349/EEC.

- Introduction of a corporate governance statement:

Under the proposal for a directive, the Corporate Governance Statement should become a specific part of the company's annual report and should also indicate certain information to be given in accordance with the Takeover Bids Directive as well as information about the risk management system, the operation of the shareholder meeting, the shareholders' rights and the operation of the board and its committees. Therefore, the Commission proposes to add a new section 9A to Directive 78/660/EEC. As for the consolidated annual report it is proposed to add a new subparagraph to Article 36 (2) of Directive 83/349/EEC limiting the information requirements to the applied risk management and internal control systems for drawing up the consolidated accounts and the consolidated annual report.

Rapporteur's view:

Your rapporteur welcomes the Commission's initiative seeking to raise confidence in the annual reports and financial statements of European firms, and enhance the transparency of transactions, by an amendment of the accounting directives.

However, in your rapporteur's view, costly and inefficient over-regulation should be avoided. Measures to enhance business transparency and liability for inappropriate behaviour should be proportionate to their actual benefit to shareholders and other interested parties. Excessive demands regarding disclosure should be avoided: the duty of disclosure should only be extended where this is relevant and necessary.

Your rapporteur considers that the inclusion of off-balance sheet transactions in the notes is not necessary, since the rules of IAS 1, Presentation of Financial Statements, already give a sufficient guarantee that information relevant to decision-making is disclosed by the companies. The Commission's proposal to this effect, which amounts to treating listed and unlisted companies in the same way is also, in your rapporteur's opinion, unnecessary, since unlisted companies by definition do not make any claims on the capital market and there is thus no "public interest" in the inclusion of off-balance sheet transactions in the notes. The duty of disclosure of transactions with related parties, which the Commission also calls for in its proposal, your rapporteur regards as disproportionate. It is hard to see how this improves protection for creditors. Furthermore, IAS 24 already creates further transparency on this point. Your rapporteur therefore proposes deleting the Commission proposals to this effect.

The proposed principle of collective responsibility for the proper drawing up and publication of the annual report and financial statement requires some clarifications. Responsibility and liability are separate, the one does not automatically entail the other. Responsibility and liability derive solely from national law. The directive does not create any new law on liability. Members of the board are only collectively responsible for the activities of the board to which they belong, and are only liable on the basis of their own responsibility. Collective responsibility exists only within a board and not between boards.

On the corporate governance statement, your rapporteur considers that it should not form part

of the financial statement, since this would require a management assessment. Your rapporteur further considers a number of the items of information required in the corporate governance statement to be superfluous and disproportionate, since the benefit of inclusion in the corporate governance statement would be far exceeded by the effort and costs involved. The information required goes far beyond what is necessary and would constitute an additional, unjustifiable burden on the company. The European legislator should not interfere in the principle of self-administration by the national Code Commissions in order to obtain the advantage of a flexible market reaction.