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THE CONSEQUENCES OF "OPTIONS" IN THE DIRECTIVE 2013/34/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON THE FINANCIAL STATEMENTS

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Abstract

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Directive 13/34/EC of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings is an instrument of the harmonisation of accounting in member states of the European Union. The Directive contains a number of various ways for recognition and measurement of financial statements, alternative forms of statements or simplifications for small and medium sized enterprises, worded as "permit or require". On the one hand, these differing ways can facilitate application of the Directive in national legislations; on the other hand, they can significantly reduce the comparability of information published in financial statements.
The aim of the paper is to verify the relation between the options to be chosen and the variability of the resulting values of the financial statement items. Based on the findings, the results are evaluated in relation to the informative function of financial reporting.

Keywords: accounting, harmonization of accounting, directive, financial statements, information.

INTRODUCTION

In June 2013, Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC (Fourth Council Directive) and 83/349/EEC (Seventh Council Directive) was adopted. The member states have the obligation to implement legal and administrative regulations necessary for the compliance with this directive by June 20, 2015. It is possible to stipulate that the regulations will be first applied to the financial statements for the period beginning on January 1, 2016.

The directive applies to the annual individual and consolidated financial statements for selected accounting entities which are listed in the annex to the directive. During the preparatory work, several investigations were carried out focusing on:

- Reduction and simplification of the administrative burden and simplification of administration, particularly for small companies;
- Improved information capacity and comparability of financial statements with an emphasis on the companies that have active cross-border activities and cooperate with a greater number of stakeholders;

- Protection of the basic needs of users, with a focus on the preservation of the necessary accounting information;
- Improved transparency of payments that the mining industry and the companies that harvest basic forests (European Commission, 2011) pay to governments.

The investigations showed that the directly participating parties (financial statement creators and users, and public authorities) are generally satisfied with the current framework, which has worked generally well over the years. The respondents saw possible changes in simplifications, in particular for the smallest companies. At the same time, they pointed out the need to improve the reliability and comparability of financial statements, in particular in the case of larger companies, which usually perform more extensive foreign operations. Improved comparability of financial statements should contribute to the better functioning of the single market and, more specifically, to an improved access to financial resources, reduced capital costs, an increased level of foreign trade, mergers, acquisitions, and similar. The directive should contribute to the improvement of Europe's competitiveness through the creation of a regulatory environment favourable to growth and job creation.

The directive is a result of about thirty years' effort of the European legislation to harmonize financial statements at the level of European Union member states. As the member states are not subject to the directive directly, but they are to create statements in accordance with national legislations which comply with the Directive framework, there has never been an agreement on content even within the EU. The information from financial statements was not considered sufficiently reliable even to be used for companies registered on stock exchanges. Based on an analysis and expert studies, the EU Commission concluded that the directives may have increased the quality of financial statements of particular member states, but did not remove the differences between the countries. Among others, the reason for this was that the directives did not contain a conceptual framework, they insufficiently defined basic items of financial statements, and there was a different level of integration of the directives into national legislations.

Harmonization of financial reporting

It is quite obvious that harmonization of financial reporting is necessary. The current condition in which 27 different systems exist within the EU is unacceptable in the long term. This has been confirmed both by institutions (European Commission, International Accounting Standards Board) and studies and publications by various authors (Baldarelli *et al.* 2012, Paseková *et al.* 2010). International harmonization of accounting has been defined as "the attempt to bring together different systems. It is the process of blending and combining various practices into an orderly structure, which produces a synergistic result (Samuels and Piper, 1985)."

International Accounting Standard IAS 1 Presentation of Financial Statements (IASB, 2015) presents financial statements as orderly expressions of the financial position and performance of an accounting entity. The objective of a general financial statement is to provide information about the financial situation and financial performance of an entity to a wide range of users who will use this information in making economic decisions. In the context of the harmonization of accounting, the focus should be on the users of accounting information, who require generally comprehensible financial statements with clearly defined items of financial statements and measuring methods.

The result of the harmonization of financial reporting should mainly be comparable financial statements which will provide information required for users' decision-making. This has been confirmed by a number of authors. Accounting as a source of information is characterised by Kovanicová (1998), who said the target to which accounting is primarily subjected is the art with which the data processed and reported by accounting can be used for the solution of decision-making tasks of various kinds. Janhuba (2010) set one of the objectives of accounting as "the naming of the set of results of practical activities carried out in the form of records in accounting books and sets of financial statements". The need for trustworthy and relevant accounting information necessary for the functioning of market economies was pointed out by Honková (2015), Kargin (2013), Ball *et al.*, (2008) or Francis, (1999). The positive influence of the quality of accounting information on the financial performance was evidenced by Lantto and Sahlström (2009). The effect of the valuation of assets on the price regulation of natural monopoly was proved by Sedláček and Valouch (2009).

Alternative solutions in the directive

In many cases, the directive contains alternative solutions to specific situations, which are indicated by words "permit or require" or references to national legislations, giving the entities potential options. The options are presented due to the fact that the accounting directives are intended for countries that come from two different accounting systems. Each European country has its national regulation system, which is based on the legal system and the way the domestic companies are financed. There are two types of legal culture, the Anglo-Saxon type and the continental type. The right of choice, the options, allow some content freedom and respect for national specifics when transposing the directives into national legislations. (Žárová, 2006)

The options will simplify the directive application to some extent, but ultimately they reduce

I: *Horizontal layout of the balance sheet, with the potential options highlighted*

		ASSETS
A.		**Subscribed capital unpaid** of which there has been called (**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).
B.		**Formation expenses** **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'
C.		Fixed assets
	I.	**Intangible assets** 1. **Costs of development**, in so far as **national law permits** their being shown as assets. 2. **Concessions, patents, licences**, trade marks and similar rights and assets, if they were: a) acquired for valuable consideration and need not be shown under C (I); or b) **created by the undertaking itself**, in so far as **national law permits** their being shown as assets.
	II.	**Tangible assets** Items recognised in the financial statements shall be measured in accordance with the principle of purchase price or production cost. Member States may **permit or require**, in respect of all undertakings or any classes of undertaking, the measurement of fixed assets at **revalued amounts**. Where national law provides for the revaluation basis of measurement, it shall define its content and limits and the rules for its application.
	III.	**Financial assets** Member States shall **permit or require**, in respect of all undertakings or any classes of undertaking, the measurement of financial instruments, including derivative financial instruments, at **fair value**.
D.		Current assets
	I.	**Stocks** Member States may **permit the purchase** price or production cost of stocks of goods of the same category to be calculated either on the basis of weighted average prices, on the basis of the 'first in, first out' (FIFO) method, the 'last in, first out' (LIFO) method, or a method reflecting generally accepted best practice.
	II.	**Debtors** Subscribed capital called but not paid (**unless national law provides** that called-up capital is to be shown as an asset under A). Prepayments and accrued income (**unless national law provides** that such items are to be shown as assets under E).
	III.	**Investments** **Own shares** (with an indication of their nominal value or, in the absence of a nominal value, their accounting par value), to the extent that national law permits their being shown in the balance sheet.
	IV.	Cash at bank and in hand
E.		Prepayments and accrued income Unless national law provides that such items are to be shown as assets under D (II).
		CAPITAL, RESERVES AND LIABILITIES
A.		Capital
	I.	**Subscribed capital** **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..
	II.	Share premium account
	III.	Revaluation reserve
	IV.	**Reserves** **Legal reserve**, in so far as **national law requires** such a reserve. **Reserve for own shares**, in so far as **national law requires** such a reserve. Reserves provided for by the articles of association. Other reserves, including the fair value reserve.
	V.	Profit or loss brought forward
	VI.	Profit or loss for the financial year
B.		Provisions
C.		Creditors **Accruals and deferred income** (unless national law provides that such items are to be shown under D).
D.		**Accruals and deferred income** (Unless national law provides that such items are to be shown under C under 'Creditors').

Source: Author's own analysis based on Directive 2013/34/EU of the European Parliament and of the Council.

Subject of examination Directive 2013/34/EU
Aim Evaluation of the directive provisions that apply to the potential options of the reporting and valuation of assets and liabilities.
The elements investigated Provisions of Directive 2013/34/EU
Analysis A detailed examination of the provisions of Directive 2013/34/EC, which are related to potential options. The choice of a suitable sample set.
Finding of the total number of solutions of the sample set.
Simulation of alternatives using a specific case study.
Generalization of the case study results to the entire sample set.
Final evaluation, formulation of conclusions.

1: *The methodological procedure of the analytical method*
Source: Authors based on Ochrana (2009)

the information capacity of the financial statements as they do not provide users with comparable information.

The options can be divided into two parts:

- Options that affect the value of the assets, liabilities and profit or loss in the statements (differences in the method of valuation and recognition of items in the financial statement).
- Options that affect the form of the financial statement (choice between two types of the balance sheet and profit and loss account, aggregation of items, simplifications for selected types of accounting entities and similar).

Items for which there are options and which affect the value of the assets, liabilities and profit or loss are shown in the balance sheet in the horizontal layout, in Tab. I.

Methodology

The aim of the paper is to verify the relationship between the options to be chosen in the Directive and the resulting values of financial statements in relation to the values of their individual parts, i.e., assets, liabilities, equity, profit and loss. Using the method of analysis, i.e., the decomposition method, in which the unit is decomposed into its individual parts and the aim is to explain the problem by a detailed examination of its components (Ochrana, 2009), Directive 2013/34/EC will be analysed; the procedure is shown in Fig. 1.

During the analysis, it was first necessary to choose the appropriate number of items in the sample set, which will be used to demonstrate the solution. We selected 5 items, each with two options, which is sufficient to demonstrate the number of possible alternative solutions. A larger sample set would not have a higher information capacity. This is not a statistical investigation, but rather an illustration, which will show the ambiguity of the results following from the number of solutions. A larger number of options and items would not help the objective pursued; in contrast, it would reduce the clarity. The selected sample set has 5 items, each item has 2 possible options, see Tab. II.

The goal is to find the total number of all solutions that could occur; then generalize the specific solution to n and k of options; using MS Excel find all solutions for the selected sample set.

Using the following list of symbols:

II: *Items for the verification of options*

	Items	Option 1	Option 2
1.	Formation expenses	Assets	Expenses
2.	Cost of development	Assets	Expenses
3.	Intangible assets created by the undertaking itself	Assets	Expenses
4.	Measurement of tangible assets	Purchase price	Revaluated amount
5.	Measurement of financial assets	Purchase price	Fair value

Source: Authors

X ......the searched number of all possible solutions
n.......the number of items
k.......the number of options
where **n, k** are natural numbers, then the resulting number of solutions is calculated according to the formula:

$$X = n^k \quad (1)$$

To quantify the effects on the balance sheet in the case study we use the balance sheet equation:

Assets = Equity + Creditors (2)

There will be changes in the balance sheet equation for items 1–3 in Tab. I when using option 1:

Increase in assets = Equity + Increase in creditors (3)

The changes in the balance sheet equation when using option 2:

Assets = Decrease in equity + Increase in creditors (4)

Equity will decrease in the profit or loss, where costs will increase.

To valuate items 4 and 5 in Tab. II, the following relationship will be valid for option 1:

Assets = Equity + Creditors (5)

The balance sheet does not change in this case, the items remain in purchase prices.

For option 2 this relationship will be valid

Increase in assets = Increase in equity + Creditors (6)

The fund of revaluation will be increased within equity.

Case study – example of a solution for a selected sample set

The directive must be transposed into national legislations of the member states; it should be used for the first time for financial statements of the year 2016. As each member state can take advantage of the options, see Tab. I, information in financial statements may not be comparable. For the verification of this fact, a simplified model example was created, displaying the consequences of the options chosen.

A simplified balance sheet (Tab. III) has been created for the needs of the model and five items with a choice between two options have been selected (Tab. IV). No particular currency is used for the purposes of the case study.

For the total number of solutions of the sample set, formula (1) is used:

$$X = 2^5 = 32$$

n=5 .. number of items in the sample set
k=2... number of options at particular items
X=.... total number of all solutions of the sample set
The number of alternatives is 32, as shown in Tab. V.

Based on the alternative solutions, shown in Tab. V, a case study was created in which the input balance sheet presented in Tab. III has been modified based on the criteria in Tab. IV and the resulting number

III: *The input balance sheet*

Balance sheet	
Items	**Value**
Fixed assets (intangible and tangible assets)	1000
Financial assets	500
Current assets	500
Total assets	**2000**
Subscribed capital	800
Profit or loss	
Revaluation reserve	
Creditors	1200
Total capital and creditors	**2000**

Source: Authors

IV: *The value of items for the verification of the possible options*

	Items	Value	Option 1	Option 2
1.	Formation expenses	100	Assets	Expenses
2.	Cost of development	200	Assets	Expenses
3.	Intangible assets created by the undertaking itself	150	Assets	Expenses
4.	Measurement of tangible assets (revaluated amount)	1250	Purchase price	Revaluated amount
5.	Measurement of financial assets (fair value)	630	Purchase price	Fair value

Source: Authors

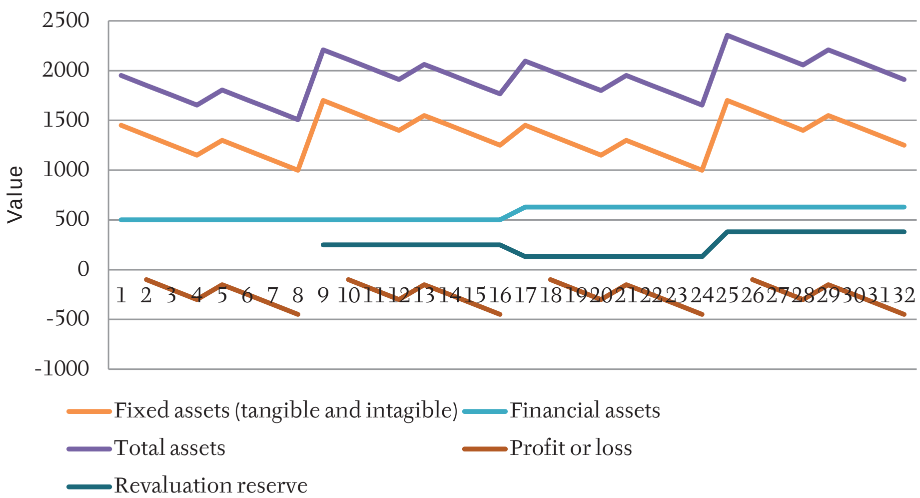
V: *Alternatives of the solution*

1	2	3	4	5	6	7	8
100 A	100 E	100 A	100 E	100 A	100 E	100 A	100 E
200 A	200 A	200 E	200 E	200 A	200 A	200 E	200 E
150 A	150 A	150 A	150 A	150 E	150 E	150 E	150 E
1000 PP	1000 PP	1000 PP	1000 PP	1000 PP	1000 PP	1000 PP	1000 PP
500 PP	500 PP	500 PP	500 PP	500 PP	500 PP	500 PP	500 PP
9	**10**	**11**	**12**	**13**	**14**	**15**	**16**
100 A	100 E	100 A	100 E	100 A	100 E	100 A	100 E
200 A	200 A	200 E	200 E	200 A	200 A	200 E	200 E
150 A	150 A	150 A	150 A	150 E	150 E	150 E	150 E
1250 RA	1250 RA	1250 RA	1250 RA	1250 RA	1250 RA	1250 RA	1250 RA
500 PP	500 PP	500 PP	500 PP	500 PP	500 PP	500 PP	500 PP
17	**18**	**19**	**20**	**21**	**22**	**23**	**24**
100 A	100 E	100 A	100 E	100 A	100 E	100 A	100 E
200 A	200 A	200 E	200 E	200 A	200 A	200 E	200 E
150 A	150 A	150 A	150 A	150 E	150 E	150 E	150 E
1000 PP	1000 PP	1000 PP	1000 PP	1000 PP	1000 PP	1000 PP	1000 PP
630 FV	630 FV	630 FV	630 FV	630 FV	630 FV	630 FV	630 FV
25	**26**	**27**	**28**	**29**	**30**	**31**	**32**
100 A	100 E	100 A	100 E	100 A	100 E	100 A	100 E
200 A	200 A	200 E	200 E	200 A	200 A	200 E	200 E
150 A	150 A	150 A	150 A	150 E	150 E	150 E	150 E
1250 RA	1250 RA	1250 RA	1250 RA	1250 RA	1250 RA	1250 RA	1250 RA
630 FV	630 FV	630 FV	630 FV	630 FV	630 FV	630 FV	630 FV

Source: Authors
Notes to the table:
A = Assets, E = Expenses, PP = Purchase price, RA = Revaluated amount, FV = Fair value

of alternatives in Tab. V. The results were calculated using equations (2)–(6) depending on the specific option. The results of the case study are presented in Tab. VI.

The results presented in Tab. VI show that choosing different options changes the total value or even the structure of assets or equity. The changes are shown in Fig. 2. Current assets and creditors remain constant in accordance with the assignment (see Tab. VI); therefore, they are not shown in the graph.



2: *Changes in the value of assets and equity*
Source: Authors

VI: *The results of the case study*

Balance sheet											
Items	Default	1	2	3	4	5	6	7	8	9	10
Fixed assets	1000	1450	1350	1250	1150	1300	1200	1100	1000	1700	1600
Financial assets	500	500	500	500	500	500	500	500	500	500	500
Current assets	500	500	500	500	500	500	500	500	500	500	500
Total assets	**2000**	**2450**	**2350**	**2250**	**2150**	**2300**	**2200**	**2100**	**2000**	**2700**	**2600**
Subscribed capital	800	800	800	800	800	800	800	800	800	800	800
Profit or loss			–100	–200	–300	–150	–250	–350	–450		–100
Revaluation reserve								250	250		
Creditors	1200	1650	1650	1650	1650	1650	1650	1650	1650	1650	1650
Total capital and creditors	**2000**	**2450**	**2350**	**2250**	**2150**	**2300**	**2200**	**2100**	**2000**	**2700**	**2600**
Items	11	12	13	14	15	16	17	18	19	20	21
Fixed assets	1500	1400	1550	1450	1350	1250	1450	1350	1250	1150	1300
Financial assets	500	500	500	500	500	500	630	630	630	630	630
Current assets	500	500	500	500	500	500	500	500	500	500	500
Total assets	**2500**	**2400**	**2550**	**2450**	**2350**	**2250**	**2580**	**2480**	**2380**	**2280**	**2430**
Subscribed capital	800	800	800	800	800	800	800	800	800	800	800
Profit or loss	–200	–300	–150	–250	–350	–450		–100	–200	–300	–150
Revaluation reserve	250	250	250	250	250	250	130	130	130	130	130
Creditors	1650	1650	1650	1650	1650	1650	1650	1650	1650	1650	1650
Total capital and creditors	**2500**	**2400**	**2550**	**2450**	**2350**	**2250**	**2580**	**2480**	**2380**	**2280**	**2430**
Items	22	23	24	25	26	27	28	29	30	31	32
Fixed assets	1200	1100	1000	1700	1600	1500	1400	1550	1450	1350	1250
Financial assets	630	630	630	630	630	630	630	630	630	630	630
Current assets	500	500	500	500	500	500	500	500	500	500	500
Total assets	**2330**	**2230**	**2130**	**2830**	**2730**	**2630**	**2530**	**2680**	**2580**	**2480**	**2380**
Subscribed capital	800	800	800	800	800	800	800	800	800	800	800
Profit or loss	–250	–350	–450		–100	–200	–300	–150	–250	–350	–450
Revaluation reserve	130	130	130	380	380	380	380	380	380	380	380
Creditors	1650	1650	1650	1650	1650	1650	1650	1650	1650	1650	1650
Total capital and creditors	**2330**	**2230**	**2130**	**2830**	**2730**	**2630**	**2530**	**2680**	**2580**	**2480**	**2380**

Source: Authors

Explanatory notes to the graph: the x axis shows the number of each alternative from Tab. VI.

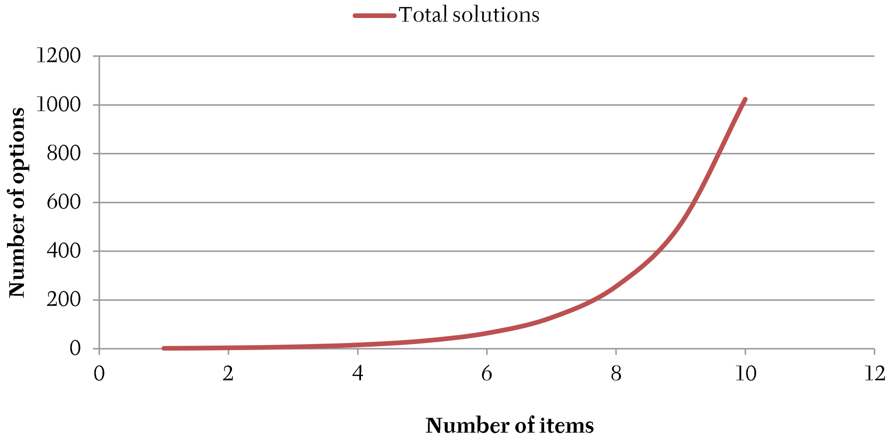
The solution of the case study can be generalized. Tab. VII and Fig. 3 show the total number of solutions depending on the number of items.

The graph shows how the number of all possible solutions (y axis) grows exponentially with the growing number of items (x axis).

VII: *The number of solutions depending on the number of items*

Number of options	**2**									
Number of items	1	2	3	4	5	6	7	8	9	10
Total solutions	2	4	8	16	32	64	128	256	512	1024

Source: Authors



3: *The number of solutions depending on the number of items*
Source: Authors

CONCLUSION

Directive 13/34/EC of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings is the current directive, and it is the instrument of the accounting harmonisation in member states of the European Union. The directive aims to improve the reliability of financial statements and reduce the administrative burden, in particular of small and medium-sized enterprises. The reliability of financial statements depends on the reliability and clarity of the information they contain. The directive and its provisions contain possible options regarding the selection of the methods for the recognition and valuation of the items of the financial statement, the selection of the form of accounting reports, or simplified reporting for small and medium-sized enterprises. Each of the options makes it easier to apply the directive within the national legislation, but the information contained in the financial statements may be distorting.

This situation has been confirmed by the results of the case study in which, based on selected five items for which there are options (three items – a decision whether they will be recognized as an asset or an expense, two items-choice of valuation between the purchase price and revalued value or fair value), 32 different solutions can appear in the balance sheet (see Tab. VI). Addition of any other item with possible options increases the number of alternatives, as shown in Tab. VII and Fig. 3.

One of the directive objectives was to improve the information capacity and comparability of financial statements with an emphasis on the companies that have active cross-border activities and cooperate with a greater number of stakeholders (European Commission, 2011). The results of the case study indicate that the achievement of this objective is unsure, as the possible options can completely change the value or the structure of the reported assets, equity and loaned resources, financing as well as the profit or loss, by which users assess the financial position and performance of companies.

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