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**THE IFRS DIRECTIVE BEFORE THE COURT
OF JUSTICE OF THE EUROPEAN UNION**

Abstract: The International Financial Reporting Standards („IFRS“) are incorporated into the legal order of the European Union by the Directive 2013/34/EU on the annual financial statements. The purpose of this article is to explore the current case law of the Court of Justice of the European Union in Luxembourg („CJEU“) and to analyse some of the raised interpretive challenges which came across when the CJEU connected accounting legislation and its domestic implementation with other connected branches of internal market legal regulation. The conducted research confirms the generally presumed statement that it is the overall realization of internal market economic freedom that is referred to as a central value influencing interpretation when there are some unclear situations needed to be authoritatively decided.

Keywords: IFRS; Court of Justice of the EU; EU directives; preliminary rulings; infringement procedures.

JEL classification: F65, K33

Introduction

The article is focused on the international financial reporting standards and related legislative regulation in the European Union law, with emphasis on the case law produced by the Court of Justice of the European Union in Luxembourg (hereinafter referred as “CJEU”). The role of CJEU in the Union’s legal system is pivotal because it contributes to interpretation of unclear legal texts and is devoted to produce uniform interpretation and application of the European legislation, within all the internal Member States’ legal orders.

According to the Treaty on the functioning of the European Union (hereinafter referred as “TFEU”), there are several types of procedures before the CJEU. The most frequently used is the so-called preliminary ruling enshrined in Article 267 TFEU. This procedure can be understood as an instrument given to the national courts possessing right to pose an interpretive question relating to the European Union law to the CJEU within administrative, civil or penal proceedings carried under the national law.

This instrument is often perceived as a powerful tool to foster the European integration. Empirical evidence shows that national courts often suggest an answer promoting integration in the EU when formulating preliminary ruling interpretive questions (Wallerman, 2019).

Another often used mechanism is the infringement procedure based in the Article 259 TFEU. It allows the European Commission (together with other Member State which is rather scarce) to sue a particular Member State government and public administration because of not having properly executed the duty to ensure compatibility of national law with the European law enjoying supremacy. The CJEU has a possibility to impose a financial fine to Member State when it is proved that it failed to comply with the EU law.

The principal legal source of the accounting legislation in the EU is represented by the 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 and 83/349/EEC (hereinafter referred as “Directive 2013/34/EU”).

The directive in general is a kind of legal instrument focused on particular aim that Member States are obliged to achieve within a set timeframe by internal means and measures, without necessarily prescribing the exact measures to be taken. Therefore, directives are suitable for stepwise harmonization, not unification, of the European law. Their role in the historical development of the European internal market is indispensable; however, nowadays the European lawmakers prefer regulations to directives in new legislative actions (Křepelka, 2017).

While regulations bringing unification of the enshrined rules do not need any further actions on the national level, at least in general, the directives cannot fulfill their aims without proper implementation through national legislation, enacting new acts or updating and amending already existing ones. In case Member States fail to meet this requirement and therefore do not carry out the desired implementation of the directive, they do not comply with their duties stemming from EU law supremacy and the Commission is entitled to start the above mentioned infringement procedure before the CJEU.

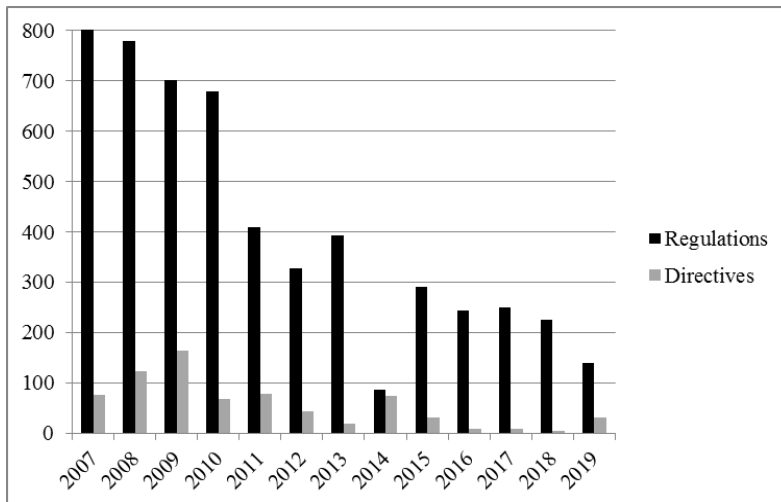


Figure 1:
The total number of newly adopted EU Regulations and Directives in 2007 – 2019 (01-08/2019)

Source: EURLEX Database.

However, some newly adopted European regulations are formulated in such a way that they require some measures of adaptation on the national level. As an example, we can mention the Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) that was adapted in the Czech Republic by the Act No. 110/2019 Coll., on the processing of personal data (Personal Data Processing Act), enacted by the Czech Parliament on 12 March 2019.

1. The European Accounting legislation

1. 1 The outline of the European legal system

The structure of European law sources encompasses several levels of formally distinct documents, performing different legal value and mutually connected by the hierarchic system (Dony, 2015).

Table 1: The sources of law in the European Union

Position in the hierarchy	Legal value	Examples
Level 1 (legislative acts)	Primary law	- Treaty on the functioning of the European Union

		- Treaty on the European Union
	Secondary law	- Directives and Regulations
Level 2 (non-legislative acts)	Implementing provisions	- Delegated and Implementing acts adopted by the European Commission
Level 3	Non-binding provisions	- Guidelines issued by Agencies, e.g. the European Banking Authority (EBA)

Source: EURLEX Database.

It is useful to make a direct reference to implementing and/or delegated acts that are to be prepared later by the European Commission right in the text of the legislative act adopted by the European Parliament and the Council of the EU during ordinary legislative procedure, formerly known as so called co-decision mechanism. The above mentioned direct reference stands for delegation properly listing (1) the provisions of the legislative act that are going to be developed further by the delegated or implementing act and (2) the duration of timeframe in the course of which the delegation is to be valid (Schutze and Tridimas, 2018).

The delegated acts are enshrined in the Article 290 SFEU, while implementing acts can be found in Article 291 SFEU. The implementing acts cannot amend the basic legislative act in any way, while the delegated act can add or alter some particular not principal, called “non-essential” features only. The main reason for this competence of the Commission is the need to ensure uniform application within the internal market, which is why these acts cannot be adopted by Member States’ administrative bodies on an individual basis.

1.2 The IFRS Directive

Financial reporting is an indispensable source of structured accounting information ensuring a fair and true view, needed for every business entity and public administration, for tax collecting and other public policy purposes. In the EU Member States, financial reporting is harmonized in the Directive 2013/34/EU. The accounting provides reflection of the

company's economic situation and enables to project its future development on the base of legitimate expectations.

The Directive 2013/34/EU is founded on the principle of justifiable balance between legitimate interests of companies not being burdened with costly reporting and compliance requirement and of all users of reporting materials, including public institutions, who have a right on access to information contained in accounting documentation. Another balance that has to be striven for is between small entities and large corporations.

Table 2: The Directive 2013/34/EU and its implementation timeframe

Date	Required action
26 June 2013	Publication in the EU Official Journal
20 July 2013	Entered into force
20 July 2015	Expiry of the deadline for transposition – Member States are obliged to enact national laws in full compliance with the Directive 2013/34/EU
1 January 2016	All the EU companies are obliged to use the rules in their financial reporting

Source: Directive 2013/34/EU and EURLEX Database.

The declared aims of the Directive 2013/34/EU are to foster cross-border investment and to improve public confidence in financial statements of trading companies, while enhancing the clarity and comparability of financial information. All the rules respect the accounting principle “substance over form.” However, a significant number of exceptions and derogation possibilities open for Member States in the Directive limit the potential of reaching full comparability of financial reporting across Europe (Lang and Martin, 2016).

The Directive brought some changes in comparison to the previous regulation: such as new definition of net turnover or new size thresholds for delimitation of small, medium and large companies. However, the way these thresholds are formulated may lead to differing effects in various Member States according to the share of SMEs in their national economy (see Figure 2). In some Member States, SMEs do have an obligation to provide only the balance sheet without profit and loss account.

As we can see from the implementing national accounting legislation in various Member States, many of them opted for different possibilities (Lang and Martin, 2016, p. 5) and therefore the harmonization effect cannot be profited to the full and there is a question whether the aims of the Directive 2013/34/EU could be assumed as fulfilled.

The reach of the European accounting law is in fact much broader, because it is overreaching the legal and economic relations of the EU towards third countries, by the free trade, partnership and association agreements serving as legal base for EU external relations and also for future enlargement of membership.

To ensure compatibility with generally accepted international accounting standards and fulfill proper harmonization of national legislation with IFRS rules is also a challenge for transformation economies in the CEE region (Grigoriu and Muntean, 2019). The EU and its initiatives oriented on external partnerships can provide a valuable assistance for transformation countries and their national reform programs.

The Directive 2013/34/EU states in its Article 49 that delegated acts can be issued by the European Commission, upon fulfilling certain stated conditions: there is a precise referral to provisions in Article 1(2), Article 3(13) and Article 46(2) of the Directive. The delegation shall last for an indefinite period according to Article 49 (2).

2. The CJEU Case Law

In this part of the article, we will look on the case law developed by CJEU concerning financial reporting at the EU level and various questions that happened to be raised during the process of transposition of the European standards into national legislation and, subsequently, during practical implementation.

According to the settled case law of CJEU, the interpretation of European law provisions requires not only to consider the wording of the legal acts but also the context in which it occurs and the declared aims of the normative complex the provision is situated (see, e.g. judgment C-616/15 from 2017).

Before the judgment of the CJEU is elaborated by the judges, there is one procedural step that is generally unknown in the national civil, administrative or criminal proceedings. By the CJEU, there are respectful experienced lawyers acting as Advocates General employed by supporting the judges by providing legal analyses and an expert viewpoint on discussed cases. Despite being appointed by governments of Member States, they are supposed to act as independent professionals without direct links to their countries of origin. They serve in a similar manner as employees of international organizations. However, some empirical evidence indicate that against these formally binding rules and professional ethics, some Advocates General tend to rely on political preferences of their respective governments in perspective of decisions whether to prefer further EU harmonization or rather Member States independence (Frankenreiter, 2018). It is important to note that the European judges can freely decide whether they rely on the Advocate General motivated opinion wholly or partly or whether they prefer to develop completely different line of argumentation in the decision making. Both ways of decisions reaching are equally common before the CJEU in Luxembourg. Moreover, in some cases the Advocate General decides not to intervene and the case is then decided by the judges only with the support of their assistants.

2.1 The action for annulment

The case C-508/13, decided by the CJEU in June 2015, concerned action for annulment filed by the Republic of Estonia against the EU law-making bodies (the European Parliament and the Council). The Estonian government claimed to repeal some provisions of the Directive 2013/34/EU in order to remove the reduced empowerment of public institutions to require additional accounting information from SMEs (more precisely, the condition that such a requirement has to be enshrined in national taxation law).

Estonia claimed that the European Commission did not adequately respect the principle of subsidiarity when conducting an impact assessment of the legislative proposal and moreover, that the Commission did not reflect the special position of Estonia as a Member State that reached

already a high level of digitalization of public administration that made financial reporting less costly and time demanding for all the businesses. This was claimed as leading to breach of the principle of proportionality.

The Advocate General decided not to present any statement in this case. The action was dismissed; the CJEU did not find the presented Estonian argumentation as relevant and did not annul the Directive 2013/34/EU, neither wholly or in part. According to CJEU, Estonia did not succeed in producing sufficient evidence to demonstrate the manifestly inappropriate nature of the measures adopted by the European legislature. Moreover, Estonia was ordered the costs of the proceedings as an unsuccessful party, according to the Rules of Procedure before CJEU.

When it comes to harmonization, it is not suitable to allow Member States to adopt unilateral measures towards SMEs, because it could result to situations with different level of exigencies and administrative burdens across the EU, which is in clear contradiction to the principal aims of harmonization initiatives. The CJEU also approved the conducted impact assessment and motivation of the legislative proposal leading to the adopted Directive 2013/34/EU as sufficient and adequately argued.

The aim to promote SMEs and their participation on European economic growth was stressed at the highest political level by the Capital Markets Union Action Plan, designed by the European Commission as an initiative targeted to deepen and further integrate the capital markets by provision of new sources of funding for businesses, especially for small and medium-sized enterprises, reduction the cost of raising capital and fostering cross-border investing and attract more foreign investment, with an overall aim to make the EU financial system more stable, resilient and competitive (European Commission, 2019).

As we can see from Figure 2, the total share of small and medium enterprises (SMEs) is quite high in some EU Member States, nearly reaching 100 % of existing registered companies, such as in Italy or the Netherlands, where exists already a long tradition of family business and self-employed persons activity development. When we consider the importance of them in proportion to turnover, GDP and export income in the European economies, it seems clear that the reporting standards should

take account of the limited administrative capacities of small entrepreneurs and therefore not to burden them in the same manner as large and strong companies. The European lawmaker decided to let some margin of appreciation to the Member States who can decide the exact way how to reduce the publishing obligations in favor of SMEs instead of establishing a common uniform roadmap.

2.2 The preliminary rulings – the interpretive exercises

The other cases before CJEU dealing with the accounting legislation and interpretation of Directive 2013/34/EU demonstrated clear intersections with legislation on financial and payment services.

The most recent case before CJEU, C-255/18, is not solved by any judgment yet, but the Advocate General’s statement elaborated by M. C. Sánchez-Bodony from Spain was published in June 2019.

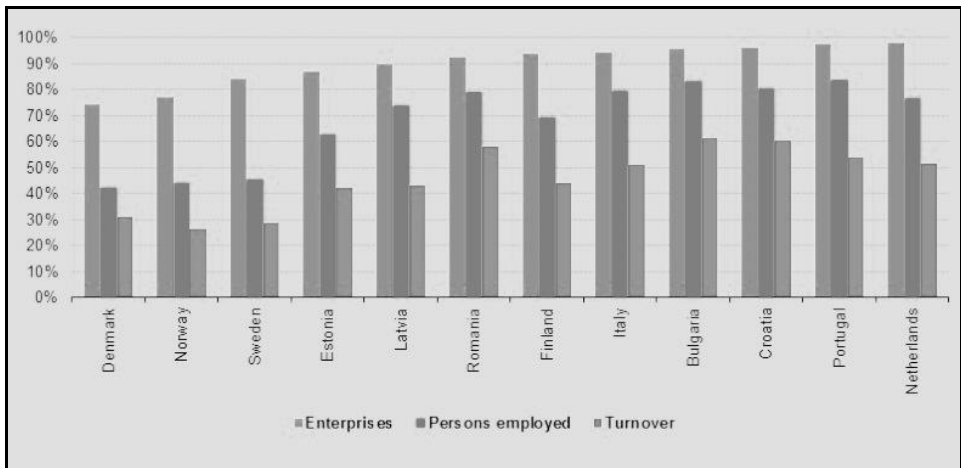


Figure 2: The total share of enterprises with less than 250 employees in selected EU Member States

Source: EUROSTAT Statistics.

The preliminary ruling was requested by a court in Italy and referred to accounting obligations for banks and groups of financial institutions. According to the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, the banks as credit institutions became obliged to provide contribution to financing

mechanisms created in the Member States and on the EU level, called Single Resolution Mechanism, in order to ensure financing of recovery and resolution of finance institutions after crisis. The amount of contribution is prescribed on the basis of reported financial documentation. Under Delegated Regulation 2015/63/EU, the banks are obliged to provide to the resolution mechanism their annual financial statements elaborated in accordance with Directive 2013/34/EU. In Italy, the competencies of such resolution mechanism are carried out by the Italian national bank (Banca d'Italia). The problem in Italy was caused by the delayed transposition, which led to confusion about the question of the exact time when this obligation was to be fulfilled at the latest. The financial institution that raised the contentious case was originally registered in Germany and its merge with Italian financial group was apparent only from the closing balance sheet for 2015 which was the year when the national transposition legislation was enacted as late as in October.

The Advocate General presents the statement that the term “change of status” used in the Directive 2014/59/EU should be interpreted extensively in order to include cross-border merges-by-acquisitions operations, such as in the present case. The European law requires unified interpretation in all the Member States; therefore it is needed to understand its key terms as having an autonomous meaning within the EU law realm. The record date is January 1 of the year for which the contributions are levied and later changes, including merges and acquisitions, cannot be relevant.

According to the Advocate General, the Delegated Regulation (Level 2, see Table 1) enjoys direct applicability in the national law although in the situation when the Directive (secondary law, Level 1 in Table 1) that is being implemented by the Delegated Regulation had not yet been transposed into the national law. It would not be acceptable to see the national implementation as a condition for validity for delegated acts, because this would enable Member States to influence their applicability by causing delays in legislative and transposition procedures. The situation of the Delegated Regulations being applicable in some Member States only and not in the rest of them would be contrary to the aims of European integration.

In the nearest future, it will be very interesting for us to read the final judgment of the CJEU and to assess whether the judges adopt the viewpoint of the Advocate General or decide to develop another line of argumentation.

We should recall the earlier case law of CJEU regarding the delimitation of the competence to issue delegated acts enshrined in Article 290 TFEU. According to the judgment from 2014, in case C-427/12, it is necessary to verify that the objectives, content, scope and duration of the delegation of power are explicitly defined in the legislative act granting such a delegation. The purpose of granting a delegated power is needed to be to achieve the adoption of rules coming within the regulatory framework as defined by the basic legislative act. Furthermore, that definition of conferred power is required to be sufficiently precise and indicate clearly the limits of the power through reference to objective criteria set by legislative acts, according to judgment from 1988, decided in case C-291/86.

Conclusion

The accounting legislative texts are closely interconnected with other fields of law regulating business environment and transactions, such as financial markets and financial institutions or international taxation (double tax avoidance methods applied to transnational corporations and their groups) or social security coordination matters.

We can now mention some measures that seem to be useful in the process of successful IFRS implementation, on the basis of the conducted research. Firstly, the accounting rules should contain some lighter version of duties imposed on small and medium enterprises that constitute a significant share on all the business corporations in many European economies. Any simplification helps reducing administrative burden and removing unnecessary compliance costs. We can appreciate that the EU Directive respects the importance of SMEs for European economic progress and includes provisions with some simplification possibilities targeted on SMEs.

Secondly, the interpretation of European law rules by CJEU is directed by the founding principles of European integration and therefore it is intended to embrace all relevant legal sources covering economic relations and to contribute to smooth functioning and progressive development of the European internal market.

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