



March 2010
AK Position Paper

Consultation on the International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social, educational, economical and consumer issues both, on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

Herbert Tumpel
President

More than three quarters of the 2 million member-consultations carried out each year concern labour, social insurance and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 – amongst others unemployed, persons on maternity (paternity) leave, community and military service – of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Werner Muhm
Director

Executive Summary

The Commission intends to adopt the new standards “IFRS for SMB (IFRS-SMB)” into European Law and now works within the scope of this consultation on the question, which role this new regulation will play in future within the framework of European Accounting. The Commission also prepares a study on accounting regulations for SMBs. The results of the study and the opinions from the consultation proceedings will flow into the revision of the Directives.

What has to be borne in mind, as a matter of principle, is the fact that International Accounting is a contributor to the current financial and economic crisis. Over the past years, fair value evaluation has more and more become part of the accounting rules of National Accounting Standards and thereby increasingly eclipsed – also at Austrian level – the prudence principle (goods recorded at a reduced value, and not its purchase or normal sale value), which is established in the Austrian Commercial Code (UGB) as well as the idea of creditor protection. During boom periods, the fair value evaluation has resulted in the recognition of not yet realised profits, whilst during the crisis, excessive value adjustments put additional burden on the balance sheets – in particular in the financial sector. The pro-cyclical effect to fair value evaluation is at the centre of the criticism.

In the opinion of the AK, the creditor protection principle is of particular significance in the SMB sector: Apart from the self-information function for companies, accounting has above all the responsibility to inform employees, clients, banks, suppliers as well as potential investors about the economic situation solvency. Any departure from the creditor protection principle results in the fact that business partners find it significantly more difficult to assess a company’s solvency. At the same time, the danger is increased that not yet realized profits are distributed, which in turn reduces the capital base for times of crisis. In addition, the creditor protection principle causes an anti cyclical distribution of successes. Therefore, there are fewer value adjustments required in times of crisis, which means that they do not put an additional burden on the economic situation of companies.

The benefit of carefully prepared, audited and published annual accounts is, from the stakeholders’ point of view, as high for SMBs as it is for large corporations and has gained in importance in particular during the course of the financial market crisis. Therefore, the AK regards it as important that the quality of accounting and its transparency for the stakeholder is improved. The AK is concerned that any further softening of accounting standards (as it would be the case

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with regard to the present standard) would have the opposite effect.

Apart from that, the extensive rules for preparing SMB annual accounts and the evaluation procedures to be applied (mixed measurement model) – such as the impairment test – could cause considerable additional expenditure for small and medium-sized businesses. In view of the AK, these complex regulations result in even more limited comparability and transparency of annual accounts. As with the creditor protection principle, these measures strongly affect all stakeholders.

Furthermore, long-term effects on the Austrian Commercial Code as well as the tax law cannot be ruled out. In accordance with the current legal position, SMBs already have the opportunity of preparing a consolidated financial statement according to the full IFRS or the Austrian Commercial Code.

The option of voluntary accounts in accordance with IFRS-SMB would, at any rate, significantly increase the accounting extent for the companies affected. In any case, single accounts in accordance with the Austrian Commercial Code form – in accordance with current law – the basis for tax assessment and profit distribution and must therefore be prepared by the companies.

The Austrian corporate landscape predominantly consists of small and medium-sized businesses. Adopting the new standard would therefore affect a major part of the Austrian economy.

With regard to selecting auditors, the AK regards the clear competitive advantage, major international audit companies have over smaller auditors as problematic as these have significantly more experience – but above all resources – with regard to auditing complex IFRS accounts, which gives them considerable advantages in auditing annual accounts of small and medium-sized businesses.

In connection with the planned review of the standard by the IASB, the AK would like to point out that it is currently still completely unclear which impact any changes of the full IFRS will have on this standard and what the consequences will be for the SMB sector.

In our opinion, the IASB will play an important role in this reviewing process, which means that any further development is in the hands of a standard setter organised under private law. The AK definitely rejects this procedure. The AK is in favour of returning the influence of private IASB within the scope of the legislative process to an advisory and supporting role. The political consensus-building process must come from the responsible democratic organs and not from private institutions. All relevant stakeholders must be involved in the voting process.

The AK is of the general opinion that uniform European Accounting Standards only make sense if basic accounting premises are discussed at European level. These premises must include the above-mentioned principles such as creditor protection,

prudence principle instead of fair value principle, publication (disclosure of annual accounts) and transparency (clear reporting provisions, reduction of voting rights). This development should be in the hands of the democratic organs of the EU and not entrusted to private standard setters such as the IASB.

As the present standard does not guarantee this, the AK rejects any further softening of the European Accounting Standards towards the IFRS. There is a danger that the basic principles, embedded in Austrian Accounting are thrown overboard.

The AK would like to comment as follows on the questions asked in the Consultation Paper.

The AK position in detail

One has to question the independence of the IFRS for SMBs.

To Question 1:

Do you think that the IFRS for SMB is suited to be widely used in Europe?

The Austrian Federal Chamber of Labour is against the Europe-wide application of the IFRS for SMBs for the following reasons:

The Standard does not define any quantitative threshold values for the classification of SMBs. This remains the right of national legislation. In this case, it remains to be seen how the EU will proceed. If every Member State is free to determine its own size criteria, it has to be pointed out that this will significantly reduce the comparability and transparency of annual accounts by European SMBs.

The basic structure of the Standard in 35 sections, compared to the full IFRS, is very welcome. Nevertheless and in spite of simplifications, it remains a very complex set of rules for SMBs. Introducing the IFRS for SMB would be associated with high conversion costs (for example for training, more employees, software etc) and subsequent costs (e.g. higher expenditure for consultations and auditing services provided by auditors/tax advisors) for the companies. The AK is of the opinion that introducing the IFRS for SMBs does not cut red tape for Austrian SMBs, but on the contrary would

increase it considerably. This development is clearly in contrast to EU measures to reduce administrative costs for business.

Furthermore, one has to question the independence of the IFRS for SMBs. Apart from a set of rules, there is currently no interpretation as "reference work" available. With regard to missing provisions (i.e. at the lowest hierarchy level of the interpretation of IFRS-SMB Accounting Standards), the Standard refers to the full IFRS, which deal with similar accounting issues. This means that companies must also consult the contents of the full IFRS and follow their developments to be able to take changes to the voting rights into account at an early stage.

The IASB intends to review the Standard in three-year intervals. It is currently completely open, which impact changes of the full IFRS will have on this new Standard resp. whether a review in these intervals is adequate.

There is the danger that the implementation of the IFRS Rules - in the long run - will abolish the preparation of national single accounts for SMBs. These IFRS Accounts could therefore be used as an assessment basis for profit distribution and tax purposes. The AK rejects this development.

From the point of view of the AK, annual accounts pursuant to IFRS-SMB do not represent a sufficient information basis for relevant stakeholders.

To question 3:

If you are an accounts user (for example a bank), do you think that accounts prepared in accordance with the IFRS for SMB provide more useful information than accounts in accordance with national GAAP?

From the point of view of the AK, annual accounts pursuant to IFRS-SMB do not represent a sufficient information basis for relevant stakeholders.

The AK above all refers to the default minimum classification for balance sheet and profit and loss account in the Standard.

As an example, we would like to mention the classification of "Equity" in equity (attributable to the shareholders of the parent company) and minority shares. Concerning further classification (in particular in subscribed capital, capital reserves) the IFRS-SMB refers to national provisions. The profit and loss account does not have to specify significant income and expense items.

In our opinion, these two examples clearly show why this Standard does not permit any objective assessment of a company's economic situation. The stakeholder would not get sufficient information from the annual accounts, which is essential for a qualitative annual accounts analysis.

Furthermore, different valuation options – the so-called "mixed measurement method" – lead to high volatility and a further lack of transparency of the results, making the comparability

of annual accounts more difficult. The AK is concerned that this results in a successive reduction of the creditor protection principles, which play a significant role in Austrian accounting. The AK is in favour of unified valuation models as well as stronger consideration of creditor protection in the Accounting Standards.

Apart from that, we would also like to point out that the regulations in the Standard repeatedly contain references to the full IFRS, which represents a further hurdle for the annual accounts analysis.

In this context, it is of particular importance for the AK, in its role as a balance sheet analyst, that the quality of accounting as well as the relevant publication for stakeholders does not deteriorate. This applies to all companies. From the point of view of employees, creditors or clients, the benefit of carefully prepared and published annual accounts of small and medium-sized businesses is as significant as those of major corporations. Employees apply the information about the economic situation of their employer to the selection of their job and to issues in connection with their remuneration. In particular, in small and micro companies, salaries, which are based on the economic performance of a company, are directly negotiated between employees and employers. Flexibilisation measures transfer more and more corporate risks on employees. This must be accompanied by a relevant transparency of the economic situation. Simplifications of accounting

as well as a reduction of transparency would result in significant disadvantages for employees affected.

To Question 5:

Should in your opinion the IFRS for SMB be adopted in the EU Accounting Standards?

The Austrian Federal Chamber of Labour is generally against an adoption of the rules into EU Accounting Standards (i.e. also against a voting right of the Member States and companies at EU level). In Austria, non-listed companies already have the option to prepare consolidated financial statements in accordance with the full IFRS or the Austrian Commercial Code. The introduction of the IFRS for SMBs could result in a third alternative for these companies.

It must also be taken into account that the increased application of IFRS rules might abolish the preparation national single accounts for the SMBs. These IFRS accounts could therefore be used as a basis for profit distributions. This is strictly rejected by the AK. Furthermore, in many Member States the national accounts are the starting point for determining the taxable income. Austria, for example, has the so-called Imparity Principle, according to which the valuations of national accounts also have to be used for determining the taxable income, provided the tax law does not explicitly provide for regulations, which deviate from the tax law. As IFRS accounts only have a very limited use for determining the taxable income, any abolition

of the current national accounts would result in the fact that determining the taxable income would be associated with higher administrative hurdles for companies as deviations between IFRS accounts and determining the taxable income would be significantly more comprehensive than is currently the case. This would result in a considerable increase of the "compliance costs".

As the new Standard does not determine any quantitative size criteria for the classification of SMBs, only the national legislator could make this decision. The consequence would be the development of different criteria in the Member States. This would result in a limited comparability and transparency of published annual accounts.

To Question 10 and 12:

In view of the publication of the IFRS for SMB, do you regard it as necessary that the Accounting Principles maintain the prescriptive character also in future?

Would you like to make any other remarks or comments on the IFRS for SMB or on the planned review of the Accounting Principles?

The AK is in favour for maintaining the prescriptive character of the EU-Accounting Principles.

The AK, however, as already mentioned at the beginning, is against an adoption of the IFRS SMB into European Accounting. These changes could be used as an opportunity to give International Accounting Standards

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more influence in European Law and thereby in national legislation.

In this context, the AK points out that due to this development the transparency and the disclosure of annual accounts will be even more limited and successively removed from the tried and tested principle of the idea of creditor protection. This creditor protection principle plays – as already mentioned above – a significant role for SMBs.

Attention must also be paid to the fact that annual accounts are an instrument of company management. Serious shortcomings can be found in particular in the SMB sector. Shortcomings in accounting – such as a lack of topicality – result in the fact that economic decisions are taken without sufficient foundations. This entails the danger of taking wrong decisions, which in turn might lead to corporate crises. Especially for that reason, these companies should not soften the Accounting Standards.



For further information please contact:

Alice Niklas

(expert of AK Vienna)
T +43 (0) 1 501 65 2701
alice.niklas@akwien.at

as well as

Amir Ghoreishi

(in our Brussels Office)
T +32 (0) 2 230 62 54
amir.ghoreishi@akeuropa.eu

Bundesarbeitskammer Österreich

Prinz-Eugen-Strasse, 20-22
A-1040 Vienna, Austria
T +43 (0) 1 501 65-0
F +43 (0) 1 501 65-0

AK EUROPA

Permanent Representation to the EU
Avenue de Cortenbergh, 30
B-1040 Brussels, Belgium
T +32 (0) 2 230 62 54
F +32 (0) 2 230 29 73