



January 2012
AK Position Paper

AK position on the COM(2011) 684 final “Directive of the European Parliament and of the Council on the annual financial statements, the consolidated financial statements and related reports of certain types of undertakings”

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

The AK position in detail

General comments

The Commission intends to review the 4th and 7th Directive. The objectives referred to concern a reduction of the administrative burden for small companies, the increase of clarity and the improvement of the comparability of companies, the protection of essential user needs - in particular the provision of the necessary accounting information - and finally the increased transparency on payments to governments by the extractive industry and loggers of primary forests.

It is a general observation that the importance of diligent accounting has been significantly increased over the past years. Increasing and often only difficult to recognise risk positions in the balance sheets, complex group structures, shifting transactions of balance sheet etc. have contributed to the fact that the significance of annual financial statements in respect of the financial soundness of a company has been reduced. These weaknesses of financial reporting came to the fore in particular during the financial market crisis. High levels of depreciation in respect of risks that have materialised resulted in large number of corporate collapses and the loss of thousands of jobs. Stricter Corporate Governance Directives, increased transparency, and more efficient statutory audits are an extract from a wide range of measures,

which since then have been demanded and have also - at least in part - been implemented at European and national level.

Hence it is very important for the Austrian Federal Chamber of Labour to emphasise from the beginning that with regard to all reform efforts in the area of financial reporting improving the quality of the annual financial statement has to take priority. This also - and in particular - applies to small and medium-sized enterprises (SME). From the point of view of employees, creditors or customers, the benefit of a diligently prepared annual financial statement is as significant for an SME as it is for a major corporation. Employees attach importance to the financial situation of an employer because it influences their choice of job and provides information relating to remuneration. In particular in small and micro enterprises wages are mainly negotiated directly between employees and employers, and are based on the economic performance of the company. Apart from that, profit sharing models are also on the increase in the SME sector; however, this requires that diligently ascertained data of the company in question has to be made available to recognise income. Based on flexibility measures, increasingly higher level of corporate risk has been shifted

to employees; this has to go hand in hand with the appropriate transparency of the economic situation of the company of the employer. Hence, any simplification of accounting and a reduction of transparency would result in significant disadvantages for the employees concerned.

It must also be taken into consideration that since Basel II - and in future reinforced through Basel III - the obligation on lending banks to assess risks diligently will be even strengthened. The quality of financial reporting has a direct and immediate influence on a company's borrowing costs. For example, the Austrian SME economy is very debtcapital oriented; more expensive loans could therefore dash the hopes of making savings in the administrative sector. Potential investors for example in the private equity sector or SME funds are also becoming increasingly subject to annual financial statements. Related to these, reduced transparency and publicity would have a counterproductive effect and make access of SMEs to these capital markets more difficult and expensive respectively.

The annual financial statement is one of the most important instruments of corporate governance. However, they are often seriously flawed in particular in the small and micro enterprise sector. Accounting deficiencies result in

economic decisions being taken without sufficient basic commercial information - bringing with them the danger of wrong decisions and subsequent corporate crises.

From the point of view of the AK, it must also be taken into account that the annual financial statement has to fulfil different functions. The key function of an annual financial statement prepared in accordance with international standards (IFRS) is the information function for investors. The Austrian financial statement, which has been prepared in accordance with the Austrian Commercial Code UGB, fulfils both the distribution and the tax assessment function complying with creditor protection. The IFRS do not know the principle of prudence in this form. Therefore, the AK regards the adoption - in particular a partial adoption - of international financial reporting provisions in view of a possible derogation of the principle of realisation as well as of the capital conservation principle as extremely critical. The AK regards the valuation principles in the draft Directive as relatively inconsistent. Although the principle of prudence is elevated to the level of general standard, in respect of individual balance sheet positions the Member States are given the option of applying fair value. This results in the application of different valuation principles within a balance sheet and in addition permits the continued use of

different valuation principles between the Member States. In accordance with the increase in transparency aimed at by the EC, a greater harmonisation would be appropriate. Apart from that, fair value valuations are in most cases characterised by complex and elaborate calculation methods and are therefore in contrast to the primary objective of the EC, to reduce the administrative costs for companies.

A reform of financial reporting should therefore pursue the following principles:

- Reduction of options - both for Member States and at corporate level - with the aim to increase the comparability of annual financial statements;
- Clear and harmonised valuation provisions, which should be in accordance with the creditor protection principle. When revaluations or valuations are to be admitted at fair value, not yet realised profits must be made clear and be subject to non-distribution rules;
- No restriction of transparency - including small and medium-sized enterprises. In particular, the balance sheet itself as well as the profit and loss account may not be compressed to such an extent that their significance is almost totally lost. This applies both to preparing the annual financial statement itself and to external transparency. Sav-

ings of administrative costs for small and medium-sized enterprises make sense; however, they should not be made at the expense of quality or publicity.

On the individual chapters and articles:

Article 2

Article 2 explains the various definitions in more detail in the Directive Proposal, which in the current Directives had been distributed in various locations. The Austrian Federal Chamber of Labour welcomes the consolidation and the provision of clearer definitions in one single Article. This ensures a better overview.

Article 3

This Article concerns the division of undertakings and groups into small, medium-sized and large categories and into small and medium-sized groups based on the balance sheet total, net turnover and average number of employees.

In general, an EU-wide harmonisation of the threshold values is regarded as being sensible. However, the AK rejects any expansion of the size categories.

Austria already raised the size criteria for the division into enterprise sizes by over 30 % in accordance with the Corporate Law Amendment Act (URÄG) 2008, which correspond roughly to the threshold values in the Directive Proposal. A large number of companies benefit from these size-dependent facilities at the expense of transparency, disclosure and information for relevant stakeholders. Yet another adjustment of the threshold values would mean a further deterioration of transparency as even more companies would come under the category “medium-sized or small enterprises”. This would thwart the improvement of transparency demanded by the Commission. In this context, the Commission also rejects an inflation-related adjustment - as is included in Article 3(10).

The threshold values for small and medium-sized groups are calculated on a consolidated basis. From the point of view of the AK, this regulation is not sensible as the companies would have to prepare a consolidated financial statement first to be able to calculate the threshold values.

The Fourth Directive Article 5 includes definitions for investment companies and financial holding companies and other companies with special classifications concerning their annual financial statements, which have been deleted in the new Directive Proposal. It is therefore not clear to the AK, what exactly this means in future for holding

companies resp. their consolidation. A main feature of holding companies is that they often only employ a small number of staff and do not generate a regular turnover. Hence, sometimes holding companies of large groups fall below the threshold of small enterprises. This means that interested stakeholders would increasingly receive information about the economic situation of these companies. Apart from that, such a measure would not ensure the improvement of transparency aimed at by the Commission.

The AK therefore demands the adoption of the relevant regulations from the Fourth Directive to obtain sufficient information on holding companies. The AK does not see any obstacle for harmonisation if branch-specific financial reporting rules exist.

Article 4

To permit the option for Member States to allow additional details for medium-sized and large companies, which go beyond the information required in accordance with this Directive is welcomed by the AK. However, small companies have been explicitly excluded from this option. However, from the point of view of the AK this does not contribute to the objective to improve transparency. The AK therefore suggests extending the option to small enterprises.

Article 5

In accordance with Article 5, the implementation of the mandatory principle of materiality for recognition, measurement, presentation and disclosure in financial statements. The AK is generally in favour of the principle of materiality. The Directive states that the determination of materiality lies first and foremost with the companies is mandatory. In case of annual financial statements, which are not subject to a statutory audit, the AK wonders who in these cases establishes which information is important and which is not (e.g. reserves, accrued and deferred income). It has to be feared that different individual interpretations of these articles could restrict the comparability of annual financial statements.

Article 6

The Directive Proposal continues to provide the option for the Member States to revalue the assets disclosed in the balance sheet - as an alternative valuation method to the purchase price or production cost basis.

In general it has to be noted with regard to fair value valuation that it, in periods of boom, has led to the recognition of non-realised profits; however, during the crisis to a large number of value adjustments in the balance sheets - in particular in the financial sector. The procyclical effect of fair value valuation is challenged by the AK.

From the point of view of the AK, the option massively restricts the comparability of annual financial statements and is therefore rejected.

Article 7

Article 7 regulates the valuation of financial instruments and certain categories of assets at fair value. Deviating from the valuation method laid down in Article 5 at purchase price or production cost, the Member States are authorised to permit a valuation at fair value.

Apart from the general critic on fair value valuation made in the comments on Article 6 illiquid markets entail the additional problem that no appropriate market value can be established. In accordance with the Directive Proposal, in this case the fair value is determined by generally recognised valuation modes. The calculated value very much depends on fixed assumptions and it is therefore difficult to come to an objective result. The AK regards it as appropriate that the planned minimum disclosures in accordance Article 17(1 c) are adhered to.

Over the past years, fair value evaluation has increasingly become part of the balance sheet rules of national financial reporting provisions and is thereby

pushing the principle of prudence (balancing at the most at purchase cost) as well as the idea of creditor protection more and more into the background.

Different valuation options between the Member States lead to less transparency of the results and make the comparability of annual financial statements more difficult. Hence, harmonising the valuation methods between the Member States would be sensible.

Paragraph 1(b) and Paragraph 9 respectively regulate the valuation for "certain categories of assets". From the point of view of the AK, the exact definition of the term "certain categories of assets" is missing. Therefore, the AK demands a more detailed explanation of the definition, as to which assets come under this category and which do not belong to it.

Article 8

Article 8(15a) regulates the valuation of associated undertakings in accordance with the equity method. According to this method, companies may be revalued by dividends. Excess revaluations have to be entered into a non-distributable reserve. The problem here is not the distribution but the different presentation of equity and thereby the lack of comparability of the annual financial statements between the Member States, as this concerns yet another option.

Article 9 and 10

The Directive Proposal now provides for a layout for the balance sheet. From the point of view of the AK this has to be welcomed as it creates a better comparability of financial statements in different EU countries.

However, in contrast to what has been laid down in Article 9, Article 10 enables the Member States to distinguish between current and non-current items. However, by deviating from the standard layout, the comparability is once again restricted. Here it would be sensible from the point of view of the AK that the exemptions from the standard layout are clearer defined or that in general no deviating from the standard layout is permitted.

The definition of reserves - in the German translation - is confusing. Instead of "provisions" point B.3 should correctly be "reserves".

Article 11

In accordance with paragraph 9, the Member States may permit that the purchase price or the production costs of assets can be calculated on the basis of "weighted average prices" or on the basis of the "first in, first out" (FIFO) method. The presentation of the EU Commission is insofar not clear as it is stated in respect of Article 11 on page

13 that the FIFO method had to be excluded. It has to be assumed that this is a translation mistake, as the English version excludes the FIFO method on page 10.

From the point of view of the AK, any restriction of possible valuation methods reduces the scope of accounting policy. In accordance with improving transparency, which is an objective of the EC, one has to welcome the restriction of the valuation methods

Article 12, 13, 14

The AK welcomes that possible layouts of the profit and loss account are restricted to the performance and turnover cost method. However, in Article 12(2), the Member States are provided with the option to present a statement of performance for certain undertakings or classes of undertaking, provided the information contents of layouts presented in Articles 13 and 14 is of equal value. From the point of view of the AK, any deviation from the minimum layout has a negative effect on comparability and transparency. Therefore, the EC should provide a more detailed explanation in the Directive, in which cases a deviation would be possible and which minimum requirements the statement of performance has to fulfil to be considered equal.

Unfortunately, the AK misses in both layouts (Articles 13, 14) subtotals for earnings before tax and the financial result (equivalent to earnings before interest and tax EBIT). However, there is also no requirement to explicitly show EBT (earnings before tax) in the layout.

From the point of view of the AK, the expenditure stated in Article 13(5) - at least in the German translation - is not specified correctly. This applies both to point (a) ("Raw materials and consumables") and to point (b) ("Other external expenses"). Based on the incorrect definition any differentiation to 8 ("other operating expenses") will be difficult to carry out.

Under the position "Staff costs", wages and salaries are disclosed together. The AK regards a detailed breakdown of wages, salaries and statutory ancillary wage costs as more informative. The position social security costs should be divided into a component "wage and salary related taxes and duties" and into a second component "severance indemnities, pensions etc." as the recipients of these benefits are different. A separate profit and loss account position should be established for contract personnel costs.

From the point of view of the AK, the required presentation of taxes is also not sensible. Article 13(14) refers to tax on extraordinary result, as does 14(12). In both cases, the English version uses the definition "tax on profit or loss". Therefore, it would be appropriate if the position would in each case refer to "income tax".

With regard to the layout of the profit and loss account - by function of expense, it has to be ensured that the types of staff costs, depreciation, material costs, other operating expenses, which are not disclosed in the layout, have to be disclosed in the notes to the financial statement.

Article 15

The AK welcomes that items of income or expense of exceptional size or incidence have to be disclosed separately in the profit and loss account and explanations must be provided in the notes to the financial statement. However, it should be specified what "exceptional" stands for.

Article 16

From the point of view of the AK, an abridged balance sheet presentation for small and medium-sized enterprises is not sensible. As all business transactions are in any case posted on individual accounting ledgers in a proper and differentiated manner and as these have to be properly closed on the balance sheet date, it is difficult to see the benefit of only showing combined items when drawing up the annual financial statement. No saving of administrative costs can be assumed. A complete annual financial statement must be drawn up in any case for corporate bodies, tax authorities and creditor banks etc. Combining individual items would have a negative

effect with regard to information for the entrepreneur himself. The reduction to combined items can therefore not be understood as a "simplification", as the title of Article 16 suggests but at best as a restriction of transparency towards third parties, and thereby counteracts the objectives aimed at by the EC to improve transparency.

Abridged presentations in the profit and loss account (gross profit) are taking the same line. The AK therefore generally rejects these "simplifications".

Chapter 4 - Notes to the financial statement

Article 17 to 19

From the point of view of the Federal Chamber of Labour, a mandatory disclosure of fixed asset items (compare Article 18 Z1 (a)) and the average number of persons employed (Article 18 Z1 (f)) is also essential for smaller undertakings and therefore has to be included in the catalogue of Article 17.

In addition, it should also be mandatory for all undertakings to separately disclose the average number of leasing employees (temporary or agency workers).

In the opinion of the AK, a summary of the emoluments granted in respect of the financial year to the members of the administrative, managerial and supervisory bodies is not adequate with regard to medium-sized to large undertakings. A breakdown into fixed and variable salary components would be sensible.

For reasons of transparency, it also appears to be appropriate with regard to large undertakings or undertakings of public importance to publish the remuneration of individual employees disclosing the fixed and variable salary components as a minimum requirement.

All disclosures required in the notes to the financial statement should naturally be fully provided in the notes to the financial statement. The AK strictly rejects permitting an extra statement in respect of parts of the notes to the financial statement and to separately file it with the competent trade or commercial and companies register. The objective of this proposal is not clear. As this cannot concern cost savings one can only assume a restriction of publicity.

The standardised regulation Article 19(1b) to separate the fees for the financial year charged by the statutory auditor or audit firm for the statutory audit of the annual financial statements, and the total fees charged by the statutory

auditor or audit firm charged for other assurance services is also relevant to the annual financial statements of medium-sized undertakings and should therefore be included in Article 18.

Particularly problematic and transparency-restricting is paragraph 2 of the Article: a regulation that Member States are not permitted to demand further disclosures from small undertakings is strictly rejected by the Federal Chamber of Labour!

Chapter 5 - Management report

Article 20

The Chamber of Labour rejects a regulation that enables Member States to exempt medium-sized undertakings from the obligation to analyse the most-important non-financial key performance indicators. An undertaking and the long-term success/profit of an undertaking cannot be measured in monetary terms alone.

The difficulty in practice lies in the fact that the terms “non-financial key performance indicator” and “information relating to environmental and employee matters” have to be concretely operationalized. However, the Directive does not give a precise definition of the

term “non-financial key performance indicators”. Analyses of the AK on reporting on non-financial key performance indicators present a sobering picture in respect to the largest Austrian undertakings.

There is not even a hint of an indicator and key figure scheme, which allows comparability between undertakings as well as over the period of several reference dates. However, reporting within the scope of such a scheme is overdue, also seen from the perspective of transparent sustainable corporate governance.

Internationally, more and more companies use the Global Reporting Initiative (GRI) for a holistic management report. Based on the indicators included therein, it should be possible to provide comparable data on performance and activities of the reporting undertaking.

The AK is in favour of relevant clear regulation on reporting and the analysis of non-financial key performance indicator as well as related reporting.

Article 21

The AK has been requesting for quite some time a transparent, informative and comprehensive disclosure relating to the diversity strategy of companies listed on the stock market. This could be achieved by including mandatory diversity reports in the annual financial

reports or as core component of the corporate governance report. In this report, the undertaking shall clearly specify which concrete measures have been taken to achieve more diversity in the employment structure, in particular in the management bodies of the European economy. Development, progress and targets must correspond to uniform criteria and quantitatively documented to ensure comparability. The publication of the measures to promote diversity in listed corporations is required to ensure a balance with regard to age, gender and internationality among executives.

Chapter 6 - Consolidation

Article 28

With regard to the disclosures on tax contribution, the notes to the consolidated financial statement should disclose both the tax incurred in the reporting year as well as the deferred taxes. In addition to these disclosure, country-specific disclosures (what is paid resp. demarcated in each individual country) beneficial.

Chapter 7 - Disclosure

Article 30

A general regulation which enables Member States to exempt undertakings from the obligation to publish a management report is strictly rejected. The additional provision that stakeholders may at their expense request a copy of at least part of the management report and at best its full version does not make the present regulation less problematic and intransparent.

The option to provide for exemptions for the general publication of a financial statement is strictly rejected. Regulations for disclosure, which provide fee-based applications, without automatic publication with the competent trade or commercial and companies registers in the end reduces stakeholders to pleaders.

Article 31

As already pointed out in Article 16, each undertaking subject to the legal obligation to keep records for corporate tax purposes has access to reliable accounting programme or systems. From the point of view of the AK, the argument of administrative costs burden cannot be applied to restrictions in respect of the transparency concerning the disclosure of annual financial state-

ments. Therefore, a profit and loss account should be fully disclosed for all undertakings, including small ones.

The AK also rejects simplification provisions with regard to an abridged balance sheet and to abridged notes to the financial statement.

Article 32

The publication of the annual financial statement should continue to be accompanied by a reproduction of the auditor's report.

Chapter 8 - Auditing

Article 34

Whilst the Fourth Directive (78/660/EEC) still required a principal obligation to produce a statutory audit, however, granted the Member States the option to exempt small undertakings from the statutory audit, this regulation is reversed in the new Article 34.

Article 34 now only regulates the audit obligation of medium-sized and large undertakings (the German version wrongly refers to small and medium-sized undertakings). In general, small undertakings should not be subject to a statutory audit. As already pointed

out, even major holding companies often only have only a small number of employees and do not generate a regular turnover. In some cases, holding companies belonging to large groups fall under the thresholds of small undertakings and as a result would not be subject to audit proceedings. In addition, it seems to be problematic that small undertakings that have a supervisory board are not obliged to carry out a statutory audit. From the point of view of the Austrian Federal Chamber of Labour it therefore needs a general regulation (as it is currently in effect in Austria § 268 (1) UGB) concerning the obligation to conduct a statutory audit of undertakings with a supervisory board, irrespective of the respective limits they exceed.

Article 35

From the point of view of the AK it should be laid down as to contents of the audit report that the main positions, for example of the profit and loss account are broken down and disclosed together with the comparison to the previous year. Austrian practice has shown that voluntary regulations do not work. Most audit reports do not include a breakdown of important positions of the profit and loss account (e.g. composition of other operational income, composition of other operational expenditure, composition of the finan-

cial result items) and important balance sheet positions (composition of receivables (in particular cash equivalents towards group companies/cash pool/treasury, composition of and growth of remaining reserves, composition of and growth of remaining obligations in particular financial obligations towards group companies).

Chapter 9 - Reports on payments to governments

The Austrian Federal Chamber of Labour expressly welcomes the new reporting obligations for large undertakings and undertakings of public interest, which are active in the extractive industry or in the logging of primary forests.

Chapter 10 - Final provisions

Article 42

As already stated in respect of Article 3, the Austrian Federal Chamber of Labour rejects a general authorisation of the Commission to undertake an inflation-related adjustment of the quantitative thresholds.

Article 43

For reasons of transparency we reject an exemption from the application of this Directive on content, audit, and disclosure for subsidiary undertakings. Particularly problematic seems to be paragraph 2, which aims at a resolution by shareholders. However, the annual financial statement is not only aimed at the owners, but it is also aimed at various other groups of stakeholders that have no influence on this resolution and subsequently do not have access to information, which might be relevant to them.

Article 45

As the individual financial statement is in any case relevant to tax and distribution assessment purposes as well as being essential for a large number of economic and operational decisions, the AK rejects an exemption from drawing up a profit and loss account for parent companies drawing up a consolidated financial statements.

Should you have any further questions
please do not hesitate to contact

Heinz Leitsmüller

T: +43 (0) 1 501 65 2640

heinz.leitsmueller@akwien.at

Alice Niklas

T: +43 (0) 1 501 65 2701

alice.niklas@akwien.at

and

Markus Oberrauter

T: +43 (0) 1 501 65 2193

markus.oberrauter@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 of Austria 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