



September 2012
AK Position Paper

Directive of the European Parliament and
of the Council on the annual financial
statements, 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.

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.

Herbert Tumpel
President

Werner Muhm
Director

Executive Summary

In October 2011, the Commission presented a new draft Directive, in which the financial reporting standards for small and medium-sized entities of the current 4th and 7th Directive shall be revised and consolidated. The objectives named included the reduction of administrative burden on companies that are relatively small in size, the creation of more clarity and the improvement of comparability of enterprises, the protection of essential needs of users - in particular the provision of accounting information required - and finally the increase of transparency with regard to payments to governments by the extractive industry and loggers of primary forests.

In Austria, the draft of the Commission was discussed at national level within the scope of a group of experts in the Federal Ministry of Justice. Representatives of statutory auditors, science, Austrian social partners as well as the Federal Ministry of Finance also participated in these discussions.

In July, the rapporteur of the Legal Committee in the European Parliament Klaus-Heiner Lehne, presented a working document (compromise proposals accounting directive) to the Committee, in which he mainly concentrates on abolishing the small and medium company audit requirement, the structure and simplifications of balance sheets as well as payments to governments by the extractive industry and loggers of primary forests.

Within the scope of this letter, we would like to outline our position to you, in particular with regard to abolishing the audit requirement.

In general it has to be said that the significance of diligent accounting has greatly increased over the past years. Increasing and in many cases only difficult to recognise risk positions in balance sheets, complex company structures, off-balance sheet transactions etc. have contributed to the fact that the information value of annual financial statements in respect of the financial soundness of a company has declined. These weaknesses of accounting became in particular apparent during the financial market crisis. High levels of depreciation caused by materialised risks lead to a large number of companies collapsing and the loss of thousands of jobs. Stricter Corporate Governance Directives, more transparency, more efficient statutory audits are only an example of a wide range of measures, which since then have been demanded and of which in the meantime at least some have been implemented both at European and national level.

This is why in the opinion of the BAK the improved quality of annual financial statements should take priority with regard to any efforts made to reform accounting. This also - and in particular - applies to small and medium-sized enterprises (SME). From the point of view of employees, creditors of customers of SMEs, the benefit of a diligently

prepared annual financial statement is as great as it is in respect of a major corporation.

Hence, from the point of view of the BAK, a reform of accounting should therefore be based on 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. Savings of administrative costs for small and medium-sized enterprises make sense; however, they should not be made at the expense of quality or publicity.

The AK position in detail

No departure from mandatory audits of annual financial statements of medium-sized companies

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

Now, Article 34 of the draft Directive only regulates the obligation to conduct a statutory audit of annual financial statements of medium-sized and large undertakings as well as of public-interest entities. In general, small undertakings should not be subject to a statutory audit. The BAK has already rejected this regulation in its statement. The BAK regards it as 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.

Auditing the annual financial statement is a key function of the supervisory board. The statutory auditor audits on behalf of the supervisory board and in

doing so supports supervisory board resp. board members with regard to auditing the annual financial statement. Hence, the attestation of a statutory auditor is therefore an indispensable basis for evaluating resp. adopting the annual financial statement for all supervisory board (resp. board) members.

The present paper of the Legal Committee attempts to also exempt medium-sized enterprises from the statutory audit. This proposal is strictly rejected by the Austrian Federal Chamber of Labour (BAK). The auditor fulfils the important reflection function in particular for the management of small and medium-sized enterprises, especially as many of these companies do not (yet) have a fully developed accounting system or where these for reasons of cost are only furnished with limited resources. In view of the increasingly more complex balance sheet regulations - in connection with national tax regulations - any exemption from the mandatory audit harbours the danger that deficiencies of the accounting systems in this sector increase, which might result in corporate crises or even insolvencies. However, more freedom with regard to balancing would also result in the fact that the trust of creditors in the figures submitted would be reduced, which might as a result increase borrowing costs. Hence, the proposed regulation would therefore be associated with significant consequence for small and medium-sized companies.

The BAK regards it as necessary, that in particular now, in economically difficult times, politicians sent a positive signal to strengthen confidence in the European capital market and the economy and to increase and not to reduce quality and transparency of accounting.

Hence, from the point of view of the BAK, medium-sized corporations - as also provided for in Article 34 of the EU Accounting Directive - shall continue to be subject to statutory audits. In addition, all "small" corporations, which have a supervisory board or a board, shall be subject to an annual statutory audit.

The BAK regards the following comments and amendments in the Directive as important:

Article 4 - Additional details

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 BAK. However, small companies have been explicitly excluded from this option. However, from the point of view of the BAK this does not contribute to the objective to improve transparency. The BAK therefore suggests extending the option to small enterprises.

Article 13, 14: more detailed information in profit and loss account

Unfortunately, the BAK 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.

Under the position "Staff costs", wages and salaries are disclosed together. The BAK 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.

With regard to the layout of the profit and loss account presented in Article 14 in accordance with 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 16: abridged representations are at the expense of transparency; however, they do not result in cost savings

From the point of view of the BAK, 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 preparing the annual financial statement. No saving of administrative costs can be assumed. A complete annual financial statement must be prepared 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 BAK therefore generally rejects these "simplifications".

Article 17: Details on employees

It should also be mandatory for all undertakings to separately disclose the average number temporary or agency workers.

Article 20: Reporting on non-financial key performance indicators

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 BAK on reporting on non-financial key performance in-

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

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

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