Switzerland’s new accounting law – an overview
Introduction to Switzerland’s new accounting law

The Swiss Federal Council enacted a new accounting law effective as of 1 January 2013 and impacting financial reporting under Swiss law.

The reform updates the accounting provisions and restructures the legislation to apply to companies regardless of their legal form. Although companies have two or three years to implement the new accounting law, it can in fact have significant accounting implications. Therefore, they are encouraged to perform an early assessment to understand the impacts. Many of the details and the related implementation of the new law are still being assessed by the accounting profession.

The new provisions are applicable for the fiscal year ending 2015 for separate financial statements and 2016 for consolidated financial statements. Early adoption of the new rules is, however, permitted and should be considered. It is highly recommend that companies carry out a preliminary analysis now in order to identify and address the applicable opportunities and risks associated with the adoption of the new law.

Executive overview of new provisions

The structure of the financial statements will change, including more detailed minimum classification requirements for the balance sheet and income statement, and additional minimum disclosure requirements in the notes. For instance, it will become mandatory to provide details of accounting and valuation principles.

Larger companies will be obliged to prepare a cash flow statement and a management report (i.e., management discussion and analysis) and to include more extensive disclosures in the notes.

Acquisition and/or production costs will continue to be used as the valuation basis for initial recognition. However, the law now expressly requires impairment testing to be carried out if there is any indication that assets are overstated or that provisions are understated. Excess reserves are still permitted in accordance with the prudence principle. Thus, valuations should continue to follow this principle, provided this does not prevent a reliable assessment of the economic situation of the business. One of the major changes pertains to the abolishment of the group valuation principle (i.e., assets now have to be valued individually). The common Swiss practice of group valuation is restricted under the new accounting law and can now only be applied for assets and liabilities that are typically grouped for valuation purposes based on their similarity.

The new accounting law introduces the concept of the functional currency. The law now specifically states that books, records and financial reporting can be presented in Swiss francs or another relevant currency for the business operations of the reporting entity. If a foreign currency is used for financial reporting, the financial statements must also be presented in Swiss francs. In such cases, the exchange rate used for translation should be disclosed in the notes.

Publicly listed companies are required to prepare their financial statements in accordance with an accepted accounting standard. This also applies to large cooperatives and foundations subject to statutory audit requirements, and when requested by qualified minority shareholders. According to an ordinance issued by the Federal Council, the following accounting frameworks have been defined as acceptable accounting standards under the new accounting law: IFRS, IFRS for SMEs, IPSAS, Swiss GAAP FER, US GAAP and FINMA regulations.
New accounting law – highlights

Most significant changes

- Accounting requirements apply regardless of legal form
- Authoritative principle (“Massgeblichkeitsprinzip”) under tax law is not affected; however, impact on tax and dividend policies should be considered
- New minimum classification requirements for the balance sheet and income statement and more extensive disclosures in the notes
- Individual valuation of assets specifically governed by the law
- Larger companies required to prepare a cash flow statement and management report
- The new accounting law will require certain companies to prepare their financial statements in accordance with an accepted accounting standard; minority shareholders can also request this application in certain circumstances
- Applicable no later than fiscal year 2015 for separate financial statements and fiscal year 2016 for consolidated financial statements
Separate financial statements

The table below summarizes the main provisions of the new accounting law based on companies' economic criteria.

<table>
<thead>
<tr>
<th>Legal form</th>
<th>Sole proprietors, partnerships, legal entities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Criteria</td>
<td>One or none of the three size criteria are met in the reporting year and in the prior year: • Total assets &gt; CHF 20m • Revenue &gt; CHF 40m • FTEs &gt; 250</td>
</tr>
<tr>
<td></td>
<td>Two of the three size criteria are met in the reporting year and in the prior year: • Total assets &gt; CHF 20m • Revenue &gt; CHF 40m • FTEs &gt; 250</td>
</tr>
<tr>
<td></td>
<td>• Publicly traded companies, required by stock exchange regulations</td>
</tr>
<tr>
<td></td>
<td>• Cooperatives with at least 2,000 members</td>
</tr>
<tr>
<td></td>
<td>• Foundations required by law to undergo a statutory audit</td>
</tr>
<tr>
<td></td>
<td>• For other organizations if requested by qualified minority shareholders</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Minimum presentation requirements of balance sheet and income statement</th>
<th>No</th>
<th>Yes</th>
<th>Yes</th>
<th>In accordance with accepted accounting standard; legal requirements must be met</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum disclosure requirements in the notes</td>
<td>No</td>
<td>Yes</td>
<td>Yes, with additional disclosures such as: • Maturity of interest-bearing liabilities • Auditors' fees for the audit of the financial statements and other services</td>
<td>In accordance with accepted accounting standard; legal requirements must be met</td>
</tr>
<tr>
<td>Valuation provisions</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>In accordance with accepted accounting standard applied</td>
</tr>
<tr>
<td>Cash flow statement</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>In accordance with accepted accounting standard applied</td>
</tr>
<tr>
<td>Management report (not subject to audit)</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Audit requirements</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

1. Shareholders that represent at least 10% of share capital (or 20% for consolidated financial statements)
   • 10% of the members (cooperatives)
   • 20% of the members (associations) (10% for consolidated financial statements; 20% for consolidated financial statements in accordance with accepted standard)
   • Shareholders or members (association) with personal liability or subject to an obligation to make further contributions

Companies subject to a statutory audit are exempt from the additional requirements (e.g., cash flow statement, management report and additional disclosures in the notes) if they belong to a group that prepares consolidated financial statements in accordance with an accepted accounting standard.

However, minority shareholders have the right to request the preparation of financial statements in accordance with the new accounting law.
Case study 1

The head of finance and administration is in charge of preparing the financial statements of the company with the key financial figures set out below:

<table>
<thead>
<tr>
<th>Example Ltd</th>
<th>Current year</th>
<th>Prior year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>CHF 10m</td>
<td>CHF 8m</td>
</tr>
<tr>
<td>Total assets</td>
<td>CHF 5m</td>
<td>CHF 6m</td>
</tr>
<tr>
<td>FTEs (annual average)</td>
<td>20</td>
<td>15</td>
</tr>
</tbody>
</table>

The shares are privately owned and most decisions are made unanimously by the owners. It can therefore be assumed that no minority shareholders will request a statutory audit or financial statements prepared in accordance with an accepted accounting standard. Based on its size, the company is required to undergo a limited statutory examination and has to comply with the general provisions of the new accounting law.

In an initial diagnostic phase the following minimum steps should be considered:

- Ensure adherence to the new minimum presentation requirements for the balance sheet and income statement (e.g., presentation of unbilled services as current assets)
- Verify whether all assets and liabilities are recorded in accordance with the new accounting law
- Prepare accounting and valuation policies for disclosure in the notes and verify whether all the relevant information is available to ensure that the notes meet the minimum legal requirements
Consolidated financial statements

Consolidated financial statements have to be prepared when a legal entity is required to prepare financial statements and controls one or more entities. Companies are exempt from this requirement if one of the following criteria are met:

- Two of the following three size criteria have not been exceeded in both the prior and the reporting year: a) total assets of CHF 20m, b) revenue of CHF 40m, and c) 250 FTEs (annual average)
- The company is controlled by another entity that prepares consolidated financial statements subject to a statutory audit in accordance with Swiss or equivalent foreign provisions
- The duty to prepare consolidated financial statements is transferred to an organization controlled by the legal entity (only possible for associations, foundations and cooperatives)

Consolidated financial statements, however, are required to be prepared if this is conducive to a reliable assessment of the economic situation or if requested by a minority shareholder or the supervisory authorities (foundations).

The new legal provisions do not include any specific accounting provisions for consolidation. Most groups will therefore be able to continue the current practice of consolidating at carrying amounts. The law only specifically requires listed companies, large cooperatives and foundations subject to a statutory audit to apply an accepted accounting standard. Minority shareholders can request that the financial statements be prepared in accordance with an accepted accounting standard.

The thresholds triggering a duty to prepare consolidated financial statements have increased significantly compared to the previous legislation (originally: total assets of CHF 10m, revenue of CHF 20m, 200 FTEs on average for the year). Higher thresholds are likely to reduce the number of legal entities required to prepare consolidated financial statements. However, careful analysis is needed to determine whether any legal entities not previously covered by the law are now required to prepare consolidated financial statements.
Case study 2

The CFO of an SME with subsidiaries in Germany and Italy is evaluating the changes of the new accounting law. The company’s key financial figures are as follows:

<table>
<thead>
<tr>
<th>HQ Ltd (separate financial statements)</th>
<th>Current year</th>
<th>Prior year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>CHF 43m</td>
<td>CHF 41m</td>
</tr>
<tr>
<td>Total assets</td>
<td>CHF 30m</td>
<td>CHF 25m</td>
</tr>
<tr>
<td>FTEs (annual average)</td>
<td>280</td>
<td>200</td>
</tr>
</tbody>
</table>

The company (HQ Ltd) exceeds the minimum size criteria for a statutory audit and therefore is required to implement the following to comply with the new accounting law:

- Implement the requirements for smaller companies (see case study 1), which also apply to larger companies
- Include a cash flow statement
- Include the following additional disclosures in the notes:
  - Maturity of interest-bearing liabilities
  - Auditors’ fees for the audit of the financial statements and other services
- Include a management report containing the outlook for future business development and details of the risk assessment

If minority shareholders request the financial statements to be prepared in accordance with an accepted standard, a GAAP conversion may need to be carried out.

The company is required to consolidate the foreign entities and prepare consolidated financial statements. Note that in this case the separate financial statements are not subject to the additional requirements (i.e., cash flow statement, extended disclosures in the notes and management report), provided that no qualifying minority shareholder requests that these be included in the separate financial statements.
Impact and required action

The new accounting law may have a significant impact on the separate or consolidated financial statements (balance sheet, income statement, cash flow statement and notes) and on the annual report (management report). The requirements must be implemented for the fiscal years ending 2015 or 2016 (i.e., after the two or three-year transitional period from the effective date 1 January 2013). Therefore, companies should start the analysis process as soon as possible to identify and address the potential benefits of early adoption and avoid negative consequences.

The abolishment of the group valuation method is likely to impact many companies and have corresponding tax implications. For instance, companies will need to carefully consider when to recognize impairment on investments with outstanding dividends – otherwise they may find themselves exposed to negative tax effects.

Although the authoritative principle ("Massgeblichkeitsprinzip") remains valid, changes in the valuation principles, including but not limited to the explicit mention of individual valuation, will need to be considered by companies in evaluating their tax and dividend policies. Early planning is crucial to minimize any potential tax implications.

Larger companies are required to prepare a cash flow statement. Companies, particularly groups, should take action now to determine what information will be required to prepare the cash flow statement.

Companies required to convert to an accepted accounting standard may have to reconsider their current finance organization and accounting processes in order to comply with the new accounting law. Organizations in this situation should evaluate the advantages and disadvantages of the various options before selecting a new accounting standard.

Furthermore, it can be assumed that most organizations will be impacted by the minimum classification requirements.

If the relevant currency for a company’s business is not the Swiss franc and the organization is considering using that currency for financial reporting purposes, it is important to consider that the financial statements must also be presented in Swiss francs, with the exchange rate disclosed in the notes.
How we can help

To avoid unwelcome surprises and take advantage of the new accounting law, it is essential for companies to start analyzing its potential impacts and benefits. Ernst & Young can offer you tailored support in the form of an initial assessment to help you evaluate what the changes mean for you.

Based on the results of this initial assessment, which will include discussions with management and the board of directors, we will work with you to determine your approach and required next steps.

We can also support you in the second phase, whereby the impact and implications will be analyzed in detail in order to develop a plan, define project milestones, determine the necessary resources and define responsibilities. In a third and final phase, Ernst & Young can support you in the execution of the required changes, then continue to support you by monitoring the implementation and training your employees to ensure the appropriate application of the new accounting law.

Methodology

**Diagnosis**

- Rough outline of the possible impact of the accounting law provisions
- Discussion and presentation at the management and board of directors level
- Decision about how to proceed

**Development**

- Determine the project team
- Define the project process and communication strategy
- Detailed analysis of target/actual status
- Revise the chart of accounts
- Prepare valuation guidelines
- Prepare a set of model financial statements in accordance with the new classification provisions
- Ensure availability of all information needed to prepare the cash flow statement
- Prepare a model management report

**Execution**

- Implement the new bookkeeping provisions
- Communicate with stakeholders
- Continuous monitoring of correct application
- Ongoing employee training

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