Modern corporate reporting involves much more than stating financial key figures.
In the spotlight: Corporate reporting

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A new year, a new issue of Disclose: two reasons to celebrate! The latest edition of our web magazine focuses on corporate reporting – a highly relevant topic that affects you on a daily basis.

In the last few decades the legal and regulatory requirements governing corporate reporting have tightened steadily, often in response to calls for transparency. Investors want more clarity on the security and development of their investments, analysts expect indications of whether corporate data is to be trusted, members of the public seek assurance that a company is taking its corporate responsibilities seriously, and governments are looking for insights into the tax relevance of customer data. It is no surprise that corporate reporting is a constant concern that ranks high on the agenda of anyone like yourself who has to make decisions and take responsibility for an organisation.

The sheer size of the latest edition of Disclose is an indication of the enormous spectrum covered by corporate reporting. These days the scope of reporting extends to providing a wealth of information on the non-financial aspects of value creation, including sustainability, corporate culture and philosophy, the ability to take an integrated approach and engage in dialogue, attitude to risk, and an assessment of future developments. The different reports and reporting processes are often intertwined, making it difficult to draw distinctions. What they all have in common is that implemented properly and intelligently they can help you manage your organisation with more far-sightedness and address your corporate responsibilities effectively for the long term.

The latest edition of Disclose is designed to give you an overview and bring you up to speed on the latest developments. We look at the hard and soft factors involved in corporate reporting, the different
forms of reporting that exist, what they are expected to contain, and how you can harness all this to add value. For the first time in years we are delighted to present a guest author. We would like to thank Professor Thomas Berndt at the Institute of Public Finance, Fiscal Law, and Law and Economics at the University of St. Gallen for providing the opening article in this issue of Disclose.

I wish you fascinating reading and plenty of insights for the new year.

Alex Astolfi
In the spotlight

**Corporate reporting:** creates more work, but more value too
by Prof. Dr. rer. pol. Thomas Berndt – page 5

**Corporate governance report:** culture in black and white
by Patrick Balkanyi – page 31

**New auditor’s report:** more transparency, more trust
by Joanne Burgener – page 59

**Integrated reporting:** better than mere compliance
by Rolf Johner – page 10

**The remuneration report:** transparency from a variety of perspectives
by Stefan Haag – page 37

**Update**
Topics in this issue:
Handling business information – Derivatives trading

**Financial reports:** trend towards individual core financial messages
by Bruno Rossi – page 18

**Tax transparency:** a wind of change sweeping the world of business
by Laurenz Schneider – page 47

**Reader service** – page 82

**Management report:** an obligatory exercise that can build trust
by Daniel Suter – page 25

**Non-financial reporting:** responsible, far-sighted management
by Stephan Hirschi – page 51
Corporate reporting is in a phase of rapid, far-reaching transformation. There are many reasons for this, with new business and financing models, new possibilities in digital publishing, tighter regulation, and a widespread need for sustainability and compliance all driving change. In the future, organisations will need to produce integrated reporting bringing together financial and non-financial information in a logical way.

Three qualities characterise good corporate reporting. Firstly, good corporate reporting is geared to the expectations of the people it’s addressed to, primarily the investors who provide equity and debt financing. Secondly, good corporate reporting is consistent and comparable. It won’t do, for example, to communicate information on a specific theme one year and then make no mention of it the next. Analysts can only evaluate companies if they can compare different reporting periods. It also has to be possible to compare different companies. Thirdly, corporate reporting has to be easy to read. User-friendly presentation of information in the form of text, tables and graphics gives readers a rapid, clear grasp of the essentials. This means leaving out information of secondary importance or pictures with no real message.

In search of form and content

In recent years a whole new set of challenges has emerged in terms of corporate reporting. There has been an increase in the amount of information assumed to be or actually necessary. This information is also changing more rapidly. Many investors complain about a growing ‘jungle of information’ or ‘information overload’. But it’s often the very same investors who demand increasing amounts of information from businesses.
Another reason for the growing surge of information lies in changes in the business reality. On the one hand business models have become more and more complex in many cases. Companies often find themselves operating in completely new areas of the market and tapping into unconventional sources of debt and equity capital. On the other hand the digital revolution and the emergence of ‘Business 4.0’ has opened up new channels of communication (see Corporate governance report).

When it comes to the form and content of their reporting, most companies are engaged in a process of searching. They’re asking what information has to be included in which report; they’re giving thought to what has to be published in printed form, and what can be made available electronically on the Internet. Not all investors like the way reporting is increasingly delivered in digital form, and many are finding it hard to let go of printed annual reports with plenty of pictures.

In the current phase of experimentation it’s harder to compare and analyse business reports. Many companies fail to see the real purpose, wrongly viewing the annual report as a kind of marketing exercise. Overdoing the creative graphics and attractive images can be counterproductive. What it’s really about is boiling down your message to provide an assessment of the economic position (see Management report).

**Regulatory response to the financial crisis**

The growing torrent of information is due in large part to the increasing number of new laws, rules and standards. Seven years may have elapsed since the financial crisis, but the regulators are still trying to respond to and process it (see Tax transparency). While it’s true that frameworks such as Basel III from the Bank for International Settlements (BIS) and edicts from the Swiss Financial Market Supervisory Authority (FINMA) are primarily aimed at the banking sector, the new regulations also have an indirect impact on businesses outside the financial services sector and their reporting. Listed companies find themselves confronted with a host of new accounting and financial reporting requirements from the International Accounting Standard Boards (IASB) and the Financial Accounting Standards Boards (FASB). The new rules contained in the International Financial Reporting Standards (IFRS) and the
United States Generally Accepted Accounting Principles (US GAAP) are so numerous and complex that their entry into force has been repeatedly postponed (see Financial report). In Switzerland there has been a notable development in the wake of the Minder Initiative and the resulting Ordinance against Excessive Compensation at Listed Companies (VegüV/ORAb): since 1 January 2014, listed companies based in this country have had to produce a compensation report (see Compensation reports).

**The sustainability trend**

A large number of companies have been dealing with the topic of sustainability in their corporate reporting for some time now (see Non-financial reporting). This is probably the clearest reflection of recent changes in the reality of business life. Organisations are increasingly gearing their business models to green and clean tech, manufacturing their products to more stringent environmental and social standards. If a company really has improved in terms of sustainability, naturally it makes sense to point this out in its reporting: do good and talk about it!

Sustainable businesses satisfy the needs of investors who take sustainability into account in their decision-making. And they take account of public opinion that increasingly rejects companies that fail to come up to appropriate standards of environmental and social behaviour.

Now the regulators are also explicitly addressing the issue of sustainability. Under Directive 2013/34/EU of the European Parliament and of the Council, for example, certain large companies will in future have to disclose information on environmental, social and employee-related strategy, risks and outcomes in their reporting (see Management report). They will have to show how they are complying with human rights, fighting corruption and working to ensure diversity in their management and oversight bodies.

**Integrated reporting initiative**

In August 2010, representatives of public institutions, companies, auditing firms, stock exchanges and standards setting organisations joined forces to create the International Integrated Reporting Council (IIRC) (see Integrated reporting). This integrated reporting initiative is a promising attempt to logically combine financial and
non-financial information. It’s not acceptable for the figures in a financial report to tell a different story from the information presented, for example, in a sustainability report. A critical investor will always ask how the sustainability measures described by a company impact monetary factors such as sales, personnel expenses, R&D and patents.

Integrated reporting is only credible if the people working for the organisation also take an integrated approach in the way they think and work. Otherwise any reporting on sustainability will fail to ring true, and critical investors and analysts will see it for what it really is: mere lip service to sustainability.

So far, no ideal form of integrated reporting has emerged. Here too, companies are in the process of seeking and experimenting, gearing their efforts to best practice and proceeding step by step. Gradually they’re addressing aspects of integrated reporting and aligning their various reports. But we’re not likely to see completely integrated reports for a few years yet.

New role for the auditors

In particular, the auditor’s role in integrated reporting still remains unclear. Many organisations shy away from including sustainability-related issues in their audited annual report. They’re afraid of setting undesired precedents and unnecessarily expanding the range of information subject to audit (see New audit report).

It’s true that there is a risk that auditors could in future refuse to sign off sustainability reports. But there are also opportunities for businesses. In 2011, for example, the Institute of Public Auditors in Germany (IDW) passed IDW Assurance Standard 980: Principles for the Proper Performance of Reasonable Assurance Engagements Relating to Compliance Management Systems (commonly known as PS 980). Many companies have come to appreciate this standard, because it sets down the basic components of a compliance management system while nevertheless allowing a certain amount of freedom in its design.
Summary

Corporate reporting is an increasingly challenging business. Besides the financial report, many investors now expect to see non-financial information on themes such as sustainability and compliance. New rules contained in IFRS and US GAAP have also helped swell the inundation of information. The rules issued by standards setting organisations such as the IASB and FASB have not got any simpler or clearer either. Ultimately, changes in corporate reporting are being driven by a complex interplay of valid investor interests, the development of communications media, new business and financing models, and increasingly tight and far-reaching regulation.

Many large companies and multinationals are in a process of experimentation. They’re testing out the possibilities of digital delivery and seeking ways of establishing integrated reporting. We recommend drawing up – and sticking to – a roadmap for continuously improving corporate reporting.

Sooner or later, small and medium-sized enterprises (SMEs) will be just as affected by the financial reporting requirements as large companies. But most are electing to wait and see what happens. In doing so they’re missing valuable opportunities because they view corporate reporting as an onerous regulatory obligation rather than a chance to communicate comprehensively on their own business efforts. It’s worth remembering that while corporate reporting creates more expense, it creates more value as well, because continuous, sustainable and transparent reporting builds investor trust.
In the spotlight: Corporate reporting

**Integrated reporting: better than mere compliance**

You can use integrated reporting (IR) to show how your business generates value. Thanks to principles-based guidelines, you can make your reporting as individual as your organisation itself. Your investors shouldn’t just believe you and the information you publish; they should also believe that your organisation is really gaining in value.

Integrated reporting is based on the IR-Framework, which is designed to facilitate the communication of value created and future challenges. Disclosure on an integrated basis means translating pure information into understandable knowledge. Integrated reporting includes messages about your corporate and market environment, strategy and allocation of resources, your business model, governance, opportunities and risks, performance and prospects of success. An IR report should help an organisation to understand the foundation and character of its value creation (see Figure 1) and present it in a form that is credible for other people, especially investors and analysts.
Practical vision

In August 2010 the main players in corporate reporting – the International Accounting Standards Board (IASB), the International Federation of Accountants (IFAC), the Global Reporting Initiative (GRI) and the Prince’s Accounting for Sustainability Project (A4S) – created the Integrated Reporting Council (IIRC) as the standards setting body for IR.

On 9 December 2013 the IIRC presented the IR-Framework. The IIRC is there to support companies seeking to take the next step in corporate reporting by communicating their value creation (see Corporate reporting). The stated goal is to anchor integrated reporting in the thinking and practices of public and private-sector organisations; implementation takes place at the level of individual organisations. The idea is for the IR-Framework to make the breakthrough in practical business by 2017.

Highly topical around the globe

Integrated reporting has become highly topical all over the world. In many countries, including South Africa and Brazil, it is viewed as a requirement for stock exchange listing. In Japan, for example, 130 organisations published an integrated report in 2015. In the UK,
companies producing an integrated report account for more than 10% of the companies listed on the most important share index (the Financial Times Stock Exchange FTSE 100 Index).

**Switzerland warming to the idea**

Switzerland presents a very mixed picture in terms of the adoption of integrated reporting. In 2013 we at PwC conducted a study called ‘Creating value through corporate reporting’, evaluating the 20 companies in the Swiss Market Index (SMI) according to the seven criteria of the IR-Framework. We found that in some areas, Swiss companies were exemplary. Larger Swiss organisations give high or very high priority to key sustainability reporting issues, at least internally. Where they currently stand in terms of implementation is difficult to judge, since IR reports are rarely published in this country.

**IR vs GRI-G4**

There are certain overlaps between the principles of IR and the fourth edition of the Global Reporting Initiative (GRI-G4). What they both have in common is the notion of materiality. So themes deemed to be material in a sustainability report can also be deemed material for integrated reporting. In both initiatives, the internal process has precedence over the formal report. The formal report, which presents the results verbally and visually, is broader in scope for IR than for GRI-G4. You will find a more detailed comparison of IR and other standards in the article "Non-financial reporting".

**A telescope for board and management**

Not another report! This is a common response among executives to the question of integrated reporting. They would rather delegate responsibility for producing an IR report to somebody else. But their response is misplaced: integrated reporting belongs on the strategic and operational management agenda. Integrated reporting is an opportunity for both the directors and the management to show where their business creates value and how it deploys financial, human and natural resources. IR helps give the people managing and overseeing an organisation clarity on the value drivers and the impact of strategy, opportunities, risks, potential and controls. This in turn facilitates the process of strategic decision-making.

Integrated reporting starts with an analysis of materiality,
encompasses the organisation’s understanding of value creation, and ends with an assessment of the extent to which objectives have been met and a panoramic view of disclosure. To this extent, IR is an expression of an integrated approach to business (see Figure 2).

Figure 2: Integrated reporting as part of an integrated approach to business

<table>
<thead>
<tr>
<th>1</th>
<th>Integrated Thinking</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Materiality analysis</td>
</tr>
<tr>
<td></td>
<td>Strategy</td>
</tr>
<tr>
<td></td>
<td>Mission and Vision</td>
</tr>
<tr>
<td>2</td>
<td>Integrated Acting</td>
</tr>
<tr>
<td></td>
<td>Policy and procedures</td>
</tr>
<tr>
<td></td>
<td>Risk Management</td>
</tr>
<tr>
<td></td>
<td>Meaningful KPIs</td>
</tr>
<tr>
<td>3</td>
<td>Integrated Reporting</td>
</tr>
<tr>
<td></td>
<td>Dashboard</td>
</tr>
<tr>
<td></td>
<td>Integrated Reporting</td>
</tr>
<tr>
<td>4</td>
<td>Integrated Auditing</td>
</tr>
<tr>
<td></td>
<td>Comfort on reported information</td>
</tr>
</tbody>
</table>

What investors want

The key to integrated reporting is for an organisation to regularly engage with the issue, especially in dialogue with investors and analysts. From this interaction directors and managers can find out what key financial and non-financial data they should be concentrating on. IR thus has benefits that go way beyond those of mere compliance. When evaluating businesses, investors and analysts concentrate primarily on metrics. To these models and observations they add assessments of industries and markets, their knowledge of the bodies that oversee and manage the business, its strategic orientation, and other information about the company. This makes it all the more important to know what information investors need and present them with the material aspects of business prosperity clearly and understandably.

Figure 3 shows the aspects investors focus on and the importance of different information for reporting. These are the themes addressed in integrated reporting.
**Figure 3:** The importance and impact of information from the point of view of investors

How important is each of these pieces of information provided by a company for your analysis, and how effective is the information that you currently receive in all aspects of company reporting?

On a scale of 0 to 100, where 0 is not at all important

<table>
<thead>
<tr>
<th>The company’s overall explanation of its business model</th>
<th>Importance</th>
<th>Effectiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>How the company generates cash</td>
<td>87</td>
<td>55</td>
</tr>
<tr>
<td>How the company creates value</td>
<td>86</td>
<td>52</td>
</tr>
<tr>
<td>Dependencies on key relationships and resources</td>
<td>74</td>
<td>39</td>
</tr>
<tr>
<td>How the business is positioned in its wider value chain</td>
<td>73</td>
<td>42</td>
</tr>
<tr>
<td>The company’s dependency and impact on the future supply of resources</td>
<td>63</td>
<td>36</td>
</tr>
</tbody>
</table>

Note: By awarding the score of 100, a respondent rates information as being of maximum importance and maximum efficiency. The term “effectiveness gap” is used to refer to the difference in relation to the declared value, if any.

**Figure 4** shows the sources of information most commonly used by investors.

**Figure 4: Sources of information and their importance for investors**

<table>
<thead>
<tr>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Information</td>
<td>Information about a company’s strategy and resource allocation</td>
<td>Information on risks and opportunities</td>
</tr>
<tr>
<td>Annual report</td>
<td>Investor presentations</td>
<td>Dialogue with management</td>
</tr>
<tr>
<td>Preliminary of results announcement</td>
<td>Dialogue with management</td>
<td>Annual report</td>
</tr>
<tr>
<td>Investor presentations</td>
<td>Annual report</td>
<td>Investor presentations</td>
</tr>
</tbody>
</table>

**Integrating perspectives**

An organisation can use integrated reporting to show why, in connection with providing products and services, it pays attention to things like a strong R&D process, stable, long-term trade
relationships, the efficient use of resources, or the continuous
development of human capital. A broad presentation enables
investors to assess more accurately how this type of engagement
impacts the value of the business in the long term, and what
parameters influence value. Integrated reporting thus makes it easier
to procure debt and equity financing.

**Content before form**

The annual IR report is ‘merely’ the result of or insights from a
comprehensive process that go under the banner of financial and
non-financial key performance indicators. Ideally an IR report is so
straightforward that it can be understood not just by trained experts,
but also by private investors and media representatives with no
specific technical knowledge. Precisely because it’s prepared in
accordance with a framework rather than legal rules and regulations,
it can be designed to reflect the priorities, point of view and language
of the organisation. It has to show what strategy is to be used to
mitigate which risks, what was achieved in the year under review,
and how the achievement of these objectives is measured. This
should also include mention of initiatives that cannot be quantified
or that can only be quantified to a limited extent.

**Introducing and establishing integrated reporting**

Implementing the integrated reporting process within your
organisation starts with defining materiality, and gaining a precise
knowledge of value creation and its impact. In practice we
recommend a step-by-step approach.
South Africa leads by example

Governance requirements in South Africa have their roots in the country’s history, and are set down in the King Report on Corporate Governance. They are based on the pillars of leadership, sustainability and good corporate citizenship. In a nutshell, they rest on the assumption that responsibility is a socially valuable commodity. The idea was to give a society in the process of being built a corporate governance framework including economic responsibility. On the basis of the King Report, the South African stock exchange (JSE) requires an IR report for listing, and most listed companies publish one. Some private organisations have followed suit by initiating their own internal IR process, or by also publishing an IR report. But IR isn’t yet rooted in companies’ DNA and philosophy; most assume their duty is done with the publication of an IR report. There is no alignment between internal and external
reporting. Nevertheless, some companies use IR information as the basis of their internal decision-making process. In South Africa, IR reports are prepared by management. The main focus of their work is on defining target groups – primarily investors – and their needs. This is then enriched with information from discussions with key figures inside and outside the company. The main players in this process are the CFO, the investor relations team and the sustainability managers. The IR report is signed off by the audit committee. The companies affected take a positive view of the JSE’s requirement, and see IR as a welcome tool for communicating value creation. Investors share their opinion: professionals in the financial business who take a long term view see IR as useful, while those who think in the short term are less convinced.

Taking the example of Vodacom, the JSE listed mobile network operator, you can find out more here about how an integrated report (IR) can be structured.

**Summary**

IR creates an effective and efficient reporting culture. Rather than making your company vulnerable, transparency can help unleash new forces within your organisation. For this reason managers and decision-makers should take a good look at integrated reporting and keep close track of the latest developments. You can start by identifying key topics and material resources, ranking them by urgency, and talking about them internally. This way you can create awareness within the organisation and initiate this valuable process.
**In the spotlight: Corporate reporting**

**Financial reports: trend towards individual core financial messages**

Revised financial reporting requirements under the Swiss Code of Obligations (CO) and new International Financial Reporting Standards (IFRS) are affecting management’s role in the production of financial statements. People reading the financial section of an annual report have to be able to gain a rapid and accurate picture of the entity’s economic position. But the growing complexity of financial reporting is an obstacle to efforts to create transparency.

Entities listed on the SIX Swiss Exchange produce financial reports on the basis of different recognised standards (see Figure 1). The most common is IFRS, the standard issued by the International Accounting Standards Board (IASB). This is followed by the Swiss GAAP FER Accounting and Reporting Regulations, and the rules for banks issued by the Swiss Financial Market Supervisory Authority (FINMA) on the basis of Swiss GAAP FER. In fourth and last place come the United States Generally Accepted Accounting Principles (US GAAP). Since 2012 the share of Swiss GAAP FER among the financial statements produced by all SIX-listed companies has risen from 18% to 27%. This shift to Swiss GAAP FER has mostly been at the expense of IFRS, whose share has fallen from 68% to 61% over the same period. The percentages of companies reporting under US GAAP and the rules for banks have remained stable.
When listing securities, SIX makes a distinction between different regulatory standards depending on security category, listing requirements and financial reporting standard (see Figure 2). Swiss GAAP FER is increasingly popular among large Swiss companies whose shares are not traded on the stock exchange. Other companies and foundations base their financial reporting on the rules set out in the Swiss Code of Obligations (CO).

The international standards and Swiss GAAP FER, like the CO, require the principle of prudence to be applied. Even so, they are fundamentally different from the CO rules in that they aim for a fair representation of an entity’s financial position. The CO is domestic legislation that places the emphasis on the principle of prudence in

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**Figure 1: Number and percentage of SIX-listed entities using a recognised financial reporting standard**

<table>
<thead>
<tr>
<th>SIX Swiss Exchange regulatory standard</th>
<th>IFRS</th>
<th>US GAAP</th>
<th>Swiss GAAP FER</th>
<th>Standard for Banks</th>
<th>Special legal provisions</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Reporting Standard</td>
<td>☑</td>
<td>☑</td>
<td></td>
<td></td>
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<tr>
<td>Swiss Reporting Standard</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Standard for Investment Companies</td>
<td>☑</td>
<td>☑</td>
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<td>☑</td>
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<tr>
<td>Standard for Real Estate Companies</td>
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<tr>
<td>Standard for Depository Receipts</td>
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<tr>
<td>Standard for Collective Investment Schemes</td>
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<td>☑</td>
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</tbody>
</table>

**Figure 2: SIX regulatory standards applied on the listing of companies with equity securities depending on financial reporting standard**

<table>
<thead>
<tr>
<th>Financial reporting standard</th>
<th>No. of entities</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS</td>
<td>144</td>
<td>61</td>
</tr>
<tr>
<td>US GAAP</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Swiss GAAP FER</td>
<td>63</td>
<td>27</td>
</tr>
<tr>
<td>Banking law</td>
<td>20</td>
<td>8</td>
</tr>
<tr>
<td><strong>All entities</strong></td>
<td><strong>237</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
the interests of creditor protection. It permits hidden reserves on the basis of depreciation and provisions that are generally higher than under other standards. Added to this, financial statements produced in accordance with the CO are much less detailed.

**Impact of the revised Swiss Code of Obligations**

At the end of 2011 the Swiss parliament approved the revision of the financial reporting legislation. The new rules under the CO apply independently of legal form but vary according to the size of the entity. The revised standards entered into force on 1 January 2013. They have to be implemented for individual annual accounts from the 2015 financial year onwards, and for consolidated accounts from 2016.

The revised CO affects the annual financial statements for listed parent companies. There are two changes that may have a substantial impact:

1. **Presentation of a company’s own shares.** These rules have been adapted in line with IFRS and Swiss GAAP FER. An undertaking’s own shares are no longer to be carried as assets, but are to be shown separately as a reduction in shareholders’ equity.

2. **Valuation of assets such as shareholdings.** Previously these could be valued as a group. In future they will generally have to be valued on an individual basis.

In some cases the presentation of an entity’s own shares will result in a considerable reduction in shareholders’ equity. On the other hand it still remains to be seen whether the introduction of individual valuation will have any significant impact on the financial statements published by listed parent companies. Very few listed companies had adopted the new accounting law for their published 2014 financial statements. The revised CO sets down additional requirements for larger entities. These rules, based on the rules for ordinary audits, apply to entities exceeding two of the three 20-40-250 thresholds in two successive years. In other words:

- a balance sheet total of more than CHF 20 million
- sales revenues of more than CHF 40 million
- more than 250 full-time positions as an annual average.
In the future larger companies will have to produce accounts under one of the financial reporting standards mentioned above if they haven’t already adopted a standard recognised by the CO for their consolidated financial statements. In practice these additional requirements will not have a major impact.

**IFRS and US GAAP converging**

The IASB, the body responsible for IFRS, has issued a number of new rules in recent years. IFRS 9, for example, sets down clear requirements for the valuation of financial instruments. IFRS 10, 11 and 12 brought amendments to the rules and explanations relating to consolidation.

There have been other changes to IFRS related to revenue recognition. In 2018, IFRS 18 Revenue from Contracts with Customers will enter into force. At many companies this will lead to changes in the amount of revenue recognised and the point at which it is recognised, which might mean they have to adapt or even replace their IT systems. Debate continues on the introduction of a new standard governing the accounting policies applicable to leases. This is likely to lead to an increase in balance sheet total (in some industries massive increases), because a right to use a leased asset will have to be recognised as an asset and a financial liability.

Financial reporting, both in Switzerland and internationally, has undergone a major evolution over the last decade. The most significant trend is the growing convergence between IFRS and US GAAP. IFRS was originally principles-based, whereas US GAAP was primarily rules-based. While there are still substantial differences between the two positions, they have got closer as each set of standards has adopted elements and characteristics of the other.

IFRS is the most widely used standard in the world. Although it has its roots in Europe, nowadays it is also used on other continents, notably Asia and Australia. The dominance of IFRS came about because in 2007 the US Securities and Exchange Commission removed the requirement for non-US companies to reconcile their IFRS-compliant financial reports with US GAAP. In many countries IFRS is now also permitted for non-listed companies as well.

**Varying transparency requirements**
IFRS contains a number of transparency requirements that are much more detailed than those laid down under Swiss GAAP FER and the Swiss Code of Obligations. The CO, for example, requires the disclosure of liabilities vis-à-vis pension schemes, while IFRS requires a great deal of detailed information relating to pension plans, which can take up several pages and is barely comprehensible for laypeople reading the report. This raises the question of whether the core messages are readily identifiable in such a wealth of information. IFRS also insists that all entities controlled by a parent company be included in the group of consolidated companies. This means foundations and pension funds, which are deemed to be independent entities under Swiss law, also have to be included in the consolidated financial statement. While this economic point of view is common internationally, it disregards local legislation.

The obligation to disclose provisions for ongoing litigation can also be problematic: the published information might reveal management’s expectations of the outcome to the adverse party, meaning that the entity required to disclose may suffer a tactical disadvantage in the dispute. Not only this, but the amount of the provision and the timing of its recognition will vary depending on the law or standard adopted. A provision for pending legal costs will often be recognised earlier under the CO than under IFRS.

These two examples of the various transparency requirements show that the different financial reporting standards and legal requirements can only be compared to a limited extent. Management should take account of this when choosing the standard the company adopts.

**Divergent messages**

Any change in a company’s chosen financial reporting standard will impact the role of management. Given that compiling a business report is one of the non-transferable and inalienable duties of the board of directors – thus also including responsibility for accounting and financial planning – its members also have to engage with the new rules. Responsibility for the business report includes critically reviewing and approving the financial statements and annual report, including the financial section.

An analysis of annual reports shows that more and more companies are communicating in the form of core messages about their financial
results, using figures that cannot be disclosed in this form in the audited financial statements. For example, pharmaceutical companies often exclude intangible amortisation from their core results to be able to present the underlying business more clearly. Management’s rationale in such cases is that the income statement, which includes amortisation, and the cash flow statement, which is not affected by amortisation, do not paint a sufficiently clear picture of business performance.

If there are discrepancies between messages in the explanatory section of an annual report (see Management report) and the financial section, additional explanations have to be supplied. If the trend towards individual messages based on core results beyond the scope of the audited financial report continues, it will eventually no longer be possible to compare companies and their strategies. It also puts into question the goal of financial reporting: to create transparency. This gets lost once dense rules and regulations specifying detailed requirements are no longer sufficient and companies have to start defining the information required to present the development of their business in an understandable form. This is too much to expect from financial analysts, investors and other interested readers. Only financial reports produced on the basis of the same standards and requirements can be readily compared.

**Summary**

*Financial reporting is all about transparency. A financial report has to provide interested readers, from company directors and managers to analysts and other stakeholders, with the information they’re looking for quickly and accurately.*

*These days Swiss companies are producing highly meaningful financial reports. IFRS and US GAAP lay down detailed guidelines. Informed readers can glean many valuable insights from reading such reports. It’s possible to compare financial statements prepared according to international standards. The downside of international standards is their complexity. With such dense information made available these days, it’s easy – for specialists as well as laypeople – to lose track of the core messages.*
The requirements laid down in Swiss GAAP FER are much less comprehensive. In recent years some companies have switched from IFRS to Swiss GAAP FER; others use figures and indicators not required by IFRS to explain the development of their business. This all begs the question of which financial reporting standard is most relevant for Switzerland. Global companies with international shareholders often adopt IFRS, while Swiss GAAP FER is sufficient for medium-sized companies. For the latter, less information is often more: financial reports produced in line with Swiss GAAP FER are clearer and easier to read. The financial reporting requirements laid down in the Swiss Code of Obligations will remain less relevant, among other things because they’re less transparent.
In the spotlight: Corporate reporting

Management report: an obligatory exercise that can build trust

Whatever name it goes by – and the various laws and standards that govern it use a variety of different terms for the same thing – the management report is the place where an entity is required to take stock of the year under review and cast a more or less accurate look into the future. A particular challenge for auditors is assessing the soft factors in a management report. The management report is a unique opportunity to build trust – one, unfortunately, that few organisations choose to exploit.

The Swiss Code of Obligations (CO), Swiss GAAP FER, the EU Accounting Directive and US GAAP all require a management report by one name or another. The precise requirements vary depending on the country and the rules. In this article you’ll find a broad overview of the status quo.

Management reports under the Swiss Code of Obligations

In Switzerland, an annual report produced in accordance with the CO comprises an entity’s financial statements, a management report and – if required by law – consolidated accounts. Under the terms of Art. 961 CO, entities that exceed two of the relevant 20-40-250 limits and are thus subject to an ordinary audit must produce a management report. Art. 961c CO stipulates that the management report must present the business performance and the economic position of the undertaking from points of view not covered in the financial statements. In concrete terms this means providing information on the average headcount over the year (in FTE terms), the conduct of a risk assessment, orders and assignments, research and development activities, extraordinary events and future prospects. The management report must not
contradict the economic position presented in the financial statements. In most cases Art. 961 CO is redundant, as entities that exceed the 20/40/250 limits often produce consolidated financial statements in any case in accordance with a recognised financial reporting standard. Depending on the standard used, this will also require the production of a management report.

**Annual reports under Swiss GAAP FER**

The management report described in the Swiss GAAP FER Framework has to cover the following aspects:

- An outline of the economic environment in the year under review and expectations for the future
- Comments on the components of the financial statements based on the key business ratios presented in the balance sheet and income statement, and their development
- Comments on the further development of the organisation, mainly with regard to risks and opportunities for the subsequent financial year.

Swiss GAAP FER requires a more future-oriented view than the CO.

**Performance reports as per Swiss GAAP FER 21**

Swiss GAAP FER 21 governs financial reporting for charitable non-profit organisations (NPOs). The recommendation is designed to make NPO reporting more meaningful and comparable. To take account of the lack of profit motive and the way NPOs are funded, in addition to the annual accounts Swiss GAAP FER 21 requires a statement of changes in capital and a performance report. The performance report is supposed to cover matters such as the purpose and objectives of the NPO, the services it provides, details of its management, and ties to affiliated persons. To this extent the performance report corresponds to an extended management report.

**Management reports under EU Directive 2013/34/EU**

Directive 2013/34/EU of the European Parliament and of the Council entered into force on 26 June 2013, superseding the fourth
and seventh EU Directives. The so-called Accounting Directive was adopted in country-specific legislation in member states. The requirements governing management reports vary from country to country. Under Art. 19 of the Accounting Directive, an undertaking or group must provide a fair review of the development and performance of its business. The review must constitute a balanced and comprehensive analysis of the development and performance of the undertaking’s business and of its position, consistent with the size and complexity of the business. The management report is also supposed to cover the following things:

- Developments of particular importance occurring after the end of the financial year
- The likely future development of the undertaking
- Research and development activities
- Information concerning the acquisition of the entity’s own shares

All this makes producing a management report in compliance with EU Directive 2013/34/EU an extremely wide-ranging and complex undertaking. In addition, Art. 29 of the Accounting Directive also requires groups to publish a consolidated management report.

**Management commentaries under IFRS**

The International Accounting Standards Board (IASB) has published a practice statement providing a framework for the presentation of a management commentary that relates to financial statements prepared in accordance with IFRS. The practice statement is not an IFRS, which means that entities are not required to comply with the practice statement unless specifically required by their jurisdiction or the local stock exchange. Management commentaries should provide:

- A presentation of the entity’s asset, financial and earnings situation
- A narrative report on the entity’s performance, position and progress from the management’s point of view
- Information supplementing and complementing information presented in the financial statements

Management commentaries should contain both forward-looking information and information with qualitative characteristics relevant to financial reporting. It should enable readers to assess the entity’s
earning power, the strategies adopted by its management, and their plans for the business. This includes material risks, the strategy with regard to risks, the influence of resources not presented in the financial statements, and the significance of non-financial factors (see Non-financial reporting). The stock exchange in Switzerland does not require a management report. But entities that report in line with IFRS provide information on their financial position in their annual report in any case – if only because commentary of this sort is part and parcel of responsible reporting.

**Notes in accordance with US GAAP and Form 20-F**

The United States Generally Accepted Accounting Principles (US GAAP) were developed primarily with the aim of providing existing and potential investors with better information. Alongside a balance sheet, a profit and loss statement, a statement of cash flows and a statement of changes in equity, US GAAP requires notes to the financial statement including a comprehensive review of operations. The 20-F is a form filed to the US Securities and Exchange Commission (SEC) by foreign issuers that have shares traded on a US exchange. Companies subject to the requirement must use Form 20-F to file an annual report within six months of the end of the financial year. The form performs the function of a management report, placing the emphasis on detailed information relating to the history and development of the business and risk factors to which the entity is exposed.

**Imposition rather than aspiration**

Responsibility for a management report and signing it off for publication lies with the board of directors; executive management is responsible for producing the report. In many cases Swiss companies view the management report as an onerous obligation. Very few take a broad perspective, and even fewer produce a report with an integrated view (see Integrated reporting). This is a shame, because a management report is a good strategic opportunity to present yourself to investors as a well-positioned organisation that produces far-sighted reporting, building trust and enhancing your image. The clearer your management report, the easier it is to present and understand value creation within your organisation.
Challenge for auditors

Under the Swiss Code of Obligations and Swiss GAAP FER only the financial statements and, if applicable, the consolidated financial statements are audited – not the management report, which falls under the category of ‘other information’. While the auditors are not responsible for the correctness of this other information, they are responsible for ensuring that this other information does not contain discrepancies in relation to the audited financial statements. If the auditors discover discrepancies, the entity must decide whether to correct the audited financial statements or the other information. Under the EU Directive the auditor is supposed to check whether the management report tallies with the financial statements for the year in question and was produced in compliance with the applicable rules. Unlike the Swiss Code of Obligations and Swiss GAAP FER, this constitutes positive confirmation. In other words, the duties of an auditor auditing financial statements under EU law go further than in Switzerland.

Beware the pitfalls

Management reports are a major challenge, both for the people producing them and for the auditor. An EU management report, for example, is supposed to cover risks and uncertainties. This requires a detailed assessment of the company’s capabilities. Here sensitive business transactions in particular can lead to a certain conflict of interest in terms of whether information is worthy of publication or not. Providing a balanced and comprehensive analysis of the development and performance of the undertaking’s business consistent with its size and complexity entails soft factors, which are hard to define, present and verify. Here it is advisable to view the information from the same perspective and measure it by the same yardstick.

Scope for optimising effort

The EU Accounting Directive acknowledges the key role of small and medium-sized enterprises (SMEs) in the economy, and is aware of the effort involved in producing a management report. For this reason it has adopted the principle of ‘think small first’, allowing member states to exempt SMEs from the requirement to disclose non-financial information and keep the work involved in reporting within reasonable limits.
It’s also possible to optimise the effort involved in producing a proper management report from a technical point of view. Producing a management report involves bringing together data from different sources and systems, which makes the process more prone to error. These days there are various IT-based tools available to address this problem. For example the SmartNotes publishing platform can enable organisations to merge information from a variety of sources and produce and amend their financial or annual report quickly and error-free.

**Summary**

* A management report presents the development of a company’s business and its position. The precise terms used and the information required vary from one regulator and financial reporting standard to the next. In addition to a review, a management report contains forward-looking information, and covers both financial and non-financial aspects. This constitutes a challenge for auditors, who have to analyse and evaluate statements about the future and statements of a qualitative nature as well as financial aspects of the past. For organisations, a management report is an opportunity to explain strategy and present an integrated report on where the business has come from and where it’s headed. Unfortunately very few companies in Switzerland have so far capitalised on this opportunity to add value.
In a corporate governance report you demonstrate how your organisation’s farsightedness is working in the interests of stakeholders, particularly investors, and how you are putting this vision into practice in the form of appropriate, structured measures. So your corporate governance report is a way of creating lasting transparency. How far you go is up to you to decide.

Various interpretations of corporate governance – and by extension the corporate governance report – have gained currency in the business world. We see the corporate governance report as the documentation an organisation puts together to show how it has set up management and oversight structures, how these structures work in practice, and how they tie in with issues such as corporate culture, ethical behaviour and compliance. Good corporate governance is a guarantor of responsible, competent and transparent management geared to sustainable corporate success, and should work to the benefit of the organisation itself, its owners and external stakeholders.

A product of history

The regulatory efforts to establish reporting on corporate governance were prompted by a series of corporate scandals and collapses around the turn of the millennium. Several years later the financial crisis underscored the urgent need for disclosure of this type of information. And the issue came to a head once again with the emotionally charged vote on the Swiss ‘Minder Initiative’ in March 2013, which led to the formulation and enactment of the Ordinance against Excessive Compensation at Listed Companies (VegüV/ORAb).
Broadly established

The duty to disclose principles of corporate governance derives from various regulatory frameworks and recommendations on both a national and international level:

- **Swiss Code of Obligations (CO):** Although the CO doesn’t stipulate a duty to produce a corporate governance report, Art. 716a does set down the non-transferable, inalienable duties of the board of directors. A corporate governance report contains a detailed description of the way the board operates, the division of duties within it, the role and composition of all board committees, and the demarcation of powers and responsibilities.

- **SIX Exchange Regulation:** The Directive on Information relating to Corporate Governance issued by SIX on 1 September 2014 applies to all issuers whose equity securities have their primary or main listing on the SIX Swiss Exchange. It’s designed to ensure that entities provide investors with certain key information in an appropriate form. The SIX Directive also sets down the information that has to be provided by companies subject to the Excessive Pay Ordinance.

- **economiesuisse:** The Swiss Code of Best Practice for Corporate Governance of 2002 established corporate governance as a tool for self-regulation. The most recent editions, published in 2007 and 2014, emphasise the concept of sustainable corporate success as the lodestar of meaningful corporate social responsibility.

- **FINMA:** FINMA circulars 2008/24 (governing supervision and internal control at banks) and 2008/32 (corporate governance, risk management and internal controls at insurers) formulate the regulatory corporate governance requirements for financial service providers and insurers in concrete terms.

- **OECD:** The 2004 update of the OECD Principles of Corporate Governance pushed the corporate governance agenda forward in OECD member and non-member countries, and provided precise guidance for country-specific legislative and regulatory initiatives.

Weighty content

A corporate governance report presents the organisation and
governance of a company at a specific cut-off date. Specifically it shows what duties are the responsibility of the board of directors, what committees are a constitutive part of the board (e.g. the audit committee, compensation committee and governance and nomination committee), who their members are, and what is discussed in these committees. As part of the annual report, the corporate governance report is public and thus subject to the critical scrutiny of diverse stakeholders. The formal objectives and scope of corporate governance reports are set out in detail in the SIX Directive. The components include group structure, shareholders, capital structure, board of directors, executive committee, compensation, shareholdings and loans, shareholders’ participation rights, changes of control and defence measures, auditors and information policy.

**Going the extra mile**

More fundamental, existential questions underlie the regulatory disclosure requirements: What does an organisation understand by ‘good’ governance? What is its strategy? How does this strategy influence corporate governance? How does the organisation respond to key risks? How is the organisation managed and supervised? With all this in mind it’s a good idea for the people responsible for the strategic management of the organisation to look at these questions in detail and make sure the corporate governance report provides credible answers to them. This is the only way of showing readers clearly and understandably how the company is conscientiously stewarding and developing value and resources.

**Complex levels of responsibility**

Responsibility for the corporate governance report lies with the board of directors. Ideally the board will lay down the structure of the content of the report; after all, this describes how the directors perceive and perform their management and oversight responsibilities. To this extent a corporate governance report is a powerful management tool that the board of directors can use to express and emphasise its credibility in terms of strategy and selecting, rewarding and overseeing management.

**On the auditors’ radar**

There is no regulatory requirement for the corporate governance
report to be audited. Even so, reading it is one of the duties of the auditors. The PS 720 and ISA 720 auditing standards\(^1\) that apply in Switzerland require auditors to read documents containing audited financial statements and critically note any material discrepancies between the financial statements and the other information provided in these documents. The revised International Standard of Auditing (ISA) 720\(^2\) of April 2015 now requires the auditors to explicitly state in their report that they did not encounter any such discrepancies. The provisions of the International Auditing and Assurance Standards Board (IAASB) are usually adopted by EXPERTsuisse in the PS auditing standards and have been declared as obligatory requirements for Switzerland by the Federal Audit Oversight Authority (RAB/FAOA).

**Top marks for Swiss companies**

In recent years SIX-listed companies have made substantial progress in terms of corporate governance, evolving significantly at both a structural and formal level. Rather than publishing a bare minimum of superficial information, they are now clearly describing and explaining how the board operates. Even so, Swiss companies still have room for improvement in terms of content; for example they could be disclosing how their risk management functions and providing specific information on how risks are covered.

**Objective self-image**

A good corporate governance report is easy to understand and highly objective. It presents the minimum content required by the SIX Directive concisely in only a few pages. Although risk management is not a required component of corporate governance reporting, readers must be able to see what an organisation is doing to ensure risks are detected in good time and opportunities are identified, and what incentives and measures it uses to manage both sides of the risk/opportunity equation. Producing a corporate governance report involves the fine art of self-portrayal. An organisation has to combine its subjective knowledge of the true value that lies within it with the objectivity its stakeholders expect. By disclosing how board members are selected, the requirements they have to meet and the experience they’re expected to bring to the table, as well as their terms of office, responsibilities and the process of self-assessment, an organisation can create the necessary transparency in its governance system and policy. This not
only gives readers greater clarity, but enables them to compare different companies.

**Evidence of corporate culture in action**

A good corporate governance report is an attractive opportunity for companies of all sizes, from Swiss family firms to listed multinationals, and a way for them to get a holistic view of themselves (see Integrated reporting). With the entry into force of the new requirements governing the audit report, the board now has to decide what additional information it wants to disclose in the corporate governance report to be able to respond with credible information if explanations are required on the basis of key audit matters (KAMs) identified by the auditors in their report (see New audit report). Additionally, in the future the corporate governance report could well evolve into a permanent feature of integrated reporting, providing a holistic account of risk management, KAMs, sustainability, ethical behaviour, brand value and other management and compliance issues, plus details of concrete measures taken to address these matters. A corporate governance report conceived in this way would provide evidence of how far corporate culture is really lived within the organisation, by both management and staff. A large group or family firm that discloses the core value it seeks to maintain, how it does so and how it responds to abuses of this value makes compliance into a key management criterion. Interpreted this way, a corporate governance report can help close gaps between communication and reality, and between the expectations of stakeholders and the organisation’s own image of itself.

**Summary**

The idea of a corporate governance report is to show your stakeholders as objectively as possible how your organisation is assuring the sustained development of value – regardless of whether you’re a family firm or a large corporation. Even though the report is a review presenting a snapshot at a specific point in time, it should also give an idea of how you’re addressing the challenges of the future. Taking a somewhat more progressive and holistic view of corporate reporting, a corporate governance report becomes a powerful tool for establishing your corporate culture in the long term, communicating it clearly, and systematically managing it – in particular in times of turmoil where you’re having to negotiate complex market mechanisms under the scrutiny of the public and your competitors.

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We’re at your service!

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1. Swiss auditing standard PS 720: ‘Auditors’ responsibilities in connection with other information included in documents that contain the audited accounts.’ and ISA 720: ‘The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements’
2. ‘The Auditor’s Responsibilities Relating to Other Information’
In the spotlight: Corporate reporting

The remuneration report: transparency from a variety of perspectives

The remuneration report is now a firm part of the corporate reporting you’re required to provide by law. In response to persistent calls for greater transparency, it gives an account of the compensation package the shareholders are being asked to approve for the management. But what many people don’t realise is that different parts of your reporting can give different figures for the same compensation – and all these figures are correct.

A remuneration report (also known as a compensation report) is an account of the compensation granted to directors, executives and advisory board members presented to shareholders for approval at the annual general meeting. The quantitative information contained in the remuneration report is subject to scrutiny by the auditors. Remuneration reports often also provide qualitative information to help recipients understand the rewards system. This information isn’t subject to audit.

Social and political background

The requirement to publish a remuneration report was born of growing discontent regarding the rewards granted to management at large companies, which culminated in the referendum on the Minder Initiative in March 2013 and the enactment of a corresponding legal framework in the form of the Ordinance against Excessive Compensation at Listed Companies (VegüV/ORAb). The idea was to make the public aware of this issue and curb excesses in management remuneration.

Complex requirements
The VegüV/ORAb ordinance governs the procedure for compensating managers and directors at Swiss companies whose shares are listed in Switzerland or abroad. It requires disclosure in the remuneration report of the rewards granted to current and future members of the board of directors, executive management and advisory board. The report must also contain prior-year figures for comparison. The disclosure requirement applies regardless of whether the recipients of compensation are employed in Switzerland, or work in this country and live abroad. The ordinance also prohibits specific forms of compensation such as severance payments and payments in advance. Even though the remuneration report doesn’t have to be submitted to the annual general meeting (AGM) for approval, it does help shareholders make an informed decision in the vote on compensation (say-on-pay).

**Legal framework**

**Ordinance against Excessive Compensation at Listed Companies (VegüV/ORAb)**

*In force since 1 January 2014, the VegüV/ORAb ordinance requires a remuneration report for 2014 and subsequent periods. It overrides the transparency legislation, but not all of its provisions. The remuneration report replaces only the information contained in the notes to the financial statements, pursuant to Art. 663bbis of the Swiss Code of Obligations, with severance pay no longer allowed, and certain additions (signing-on bonuses and additional amounts for members of the executive board) and redrafts made.*

**Swiss Code of Obligations (CO)**

– Art. 663c CO is still in force. It stipulates that companies whose shares are listed on a stock exchange must specify the significant shareholders and their shareholdings in the notes to the balance sheet.

– Art. 958c CO describes the recognised financial reporting principles, Art. 958d 2-4 sets down the rules for prior-year figures, the currency and language of the report, and Art. 958f sets down the rules for keeping and retaining accounting records.*
Delineation

Organisations had to produce a remuneration report as per the VegüV/ORAb ordinance for the first time for the 2014 financial year. This took the place of disclosure under 663b\textsuperscript{bis} of the Code of Obligations. Given that there are many similarities between the two requirements, drawing up a remuneration report has been simple for companies, many of which have already achieved a high degree of transparency. Even so, in practice there are still questions when it comes to applying the rules. Particularly in the case of long-term compensation, the question arises as to how to disclose this type of reward transparently, especially given that the value of such rewards can change over time and has to be presented differently depending on the purpose. To illustrate the problem, let’s look at a simplified example.

In a prospective vote the shareholders of ABC AG grant the CEO share-based compensation in the form of a stock options plan. The CEO can acquire ten shares for free provided he works for the ABC AG group in financial years 1 and 2. Thereafter the options are subject to a lock-up period of one year. At the time of the AGM in financial year 1, the share is trading at CHF 10. At the end of financial year 2 the share price is CHF 30, and by the end of the blocking period – in other words after three years – it has reached CHF 50. The social security contribution is 10\%, calculated on the basis of the value of the shares at the moment the option is exercised. The CEO

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SIX Exchange Regulation

The Directive on Information Relating to Corporate Governance published on 1 September 2014 by SIX Exchange Regulation is based on the Stock Exchange Act. Article 6 stipulates that information relating to corporate governance is to be published in a separate section of the annual report. This section may refer to other parts of the annual report (including the remuneration report) or other easily accessible sources.

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– Art. 959c CO sets down the information to be disclosed by all entities subject to the financial reporting law. Paragraph 2 point 11 also requires non-listed entities to disclose the number and value of shares or options on shares held by management or administrative bodies and by employees.
exercises his option at the end of the third year. To meet the requirement, the requisite shares are acquired on the stock exchange at market price in year 3. We assume that the CEO is the most highly remunerated member of executive management and is employed by a subsidiary of ABC AG.

**Truth: an amalgam of different perspectives**

How much is the package awarded to the CEO in our example actually worth? To answer this question, let’s look at how this reward is presented in financial statements under IFRS and the Swiss Code of Obligations. To make things simpler we’ll leave tax out of the equation.

In the remuneration report covering financial year 1, the total allocation of ten options at a value of CHF 10 each, including the 10% in social security contributions likely to be deducted, is disclosed, giving a total figure of CHF 110. This also corresponds to the total figure voted on by the shareholders. Since the remuneration report constitutes a statement in relation to the say-on-pay, according to recognised practice no further disclosure seems to be required in the subsequent years.

In terms of the IFRS (group) financial statements, the value of the option on the grant date, CHF 10, is the determinant for the whole vesting period. Since the CEO acquires the entitlement over financial years 1 and 2, the total expense for this share-based compensation is spread over these two years, in other words CHF 50 per year. Taking account of probable social security contributions, this leads to the recognition of CHF 55 in expense in year 1, and CHF 75 in year 2. The expense in financial year 2 is calculated on the basis of the total benefit including social security contributions of CHF 130 (CHF 100 for ten shares worth CHF 10 plus 10% of ten shares worth CHF 30 the second year) minus the expense already recognised in the first year. The additional social security contributions of CHF 20 due in year 3 (10% of ten shares worth CHF 50 in the third year minus social security contributions of CHF 30 already recognised) have to be recognised as an expense at the time the option is exercised. Taken over three years, the expense under IFRS comes to CHF 150. Under the terms of IFRS, compensation paid to the CEO does not have to be disclosed separately. Instead, the key management personnel compensation for a period has to be disclosed in total and
for various individual categories (short and long-term benefits, post-employment benefits, termination benefits and share-based payment benefits).

Since there is no employment contract between ABC AG and the CEO, this share-based compensation does not have to be recognised in the financial statements of ABC AG under the Swiss Code of Obligations, nor does it have to be disclosed there under the terms of Art. 959c para 2 point 11 CO. Instead, under the Swiss Code of Obligations the compensation is recognised in the financial statements of the subsidiary of ABC AG (which in legal terms is the CEO’s employer). The subsidiary has a liability to amounting the pro rata market value of the shares and the social security contributions due on them (ultimately ten shares worth CHF 50 each plus 10% social security contributions). Accordingly the subsidiary recognises an expense of CHF 55 in the first year, CHF 275 in the second year (ten shares worth CHF 30 each plus 10% social security contributions minus the first year’s expense) and CHF 220 in the third year (ten shares worth CHF 50 each plus 10% social security contributions minus the first two years’ expense).

If you now look at the reports published by ABC AG and the financial statements for the subsidiary under the Swiss Code of Obligations for the three years, you will see the following figures for the transaction described above:

<table>
<thead>
<tr>
<th>Published remuneration report (as part of the total compensation of the CEO)</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>110</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Published consolidated financial statements under IFRS (as part of the share-based compensation of key persons)</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>75</td>
<td>20</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Published individual financial statement under the Swiss Code of Obligations for ABC AG</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Unpublished financial statement for the individual subsidiary</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>275</td>
<td>220</td>
<td></td>
</tr>
</tbody>
</table>

In other words there are different messages and figures for the same thing, and the information published in the remuneration report can deviate from the information in the financial statements for the group and individual entities. Nevertheless, the different figures for the same compensation are all correct under the terms of the rules.
applicable in each case, and are attested by the auditor accordingly. This means that comparing compensation in different reports can open up expectation gaps.

**Here too, time is often money**

Time is a key factor, especially for long-term incentive plans (LTIPs) involving share-based compensation. In terms of measuring compensation of this type, the year of allocation or grant date (often the day of the AGM) is relevant. The figures stated in the remuneration report and financial reports may differ as a result of fluctuating prices or differences in cut-off dates. For this reason the value used and the measurement date should be specified and explained in each report. While the remuneration report focuses on the amounts of compensation granted, in IFRS financial statements the focus is on recognising the expense resulting from the granting of this compensation in the relevant periods. Finally, financial reports under the Code of Obligations are geared to the settlement of the transaction.

**Heads and tails**

The say-on-pay principle enshrined in the VegüV/ORAb ordinance works on the basis of monetary amounts rather than the number of stocks or options granted. In the case of simple compensation systems this principle makes a lot of sense; after all, the shareholders want to have a say in the amounts of salary paid to their management. But if you take a prospective approach to share-based compensation it can get complex, because this can’t take account of future price developments. An estimated, promised value can fluctuate over the years. If the share price develops positively, shareholders will be delighted with their capital gains, but at the same time they might also find that the value of the share-based compensation granted to management has increased dramatically since the date on which they voted on the compensation – when the share price was relatively low. Deviations from the figures stated in the financial statements can also emerge in the event of bonuses approved retrospectively, as the books will already have been closed by the time of the AGM.

**Glossary of compensation/remuneration**
Accrual principle: A key principle of financial reporting. The accrual principle is the notion that payments should be taken account of in the periods in which they have an economic impact, and not recognised as profit or loss (i.e. not on an event-oriented basis) on the date the cash is actually paid and collected (see for example International Accounting Standard IAS 1.25, Swiss GAAP FER Framework 11 and 12, and Art. 958b CO).

Bonus: Variable compensation, therefore the term is not clearly defined in employment law. Variable compensation can be paid as a component of salary or as a discretionary bonus. A bonus may be paid in cash and/or in the form of shares and options. Bonuses are disclosed in accordance with the accrual principle.

Grant date: The date compensation is awarded, used as the basis for determining the market value of a share or option granted as compensation. In a retrospective vote on a share-based compensation plan, the grant-date value is determined retrospectively on the day of the AGM.

Long-term incentives (LTIs): Long-term compensation designed to encourage loyalty and motivate employees, in particular executives and talented and important staff. LTIs for future contributions are disclosed in the remuneration report in the year they were allocated.

Employee option: A form of employee participation. The option entitles the employee to acquire a defined number of shares over an agreed period of time at a predetermined price. Employee participation plans often involve non-tradeable and non-transferable options.

Performance share units (PSUs): Free shares awarded to employees subject to the fulfilment of performance targets.

Restricted share units (RSU): Shares subject to a lock-up. By contrast with an employee option, the share is granted free of charge; in other words, the employee does not have to pay an exercise price. The employee has no influence on the date the shares are allocated and the corresponding
Watch out when social security contributions are involved

In a narrow sense, social security contributions constitute a pension promise to employees. The VegüV/ORAb ordinance requires companies to state as compensation any expenses that establish or increase entitlements to employee benefits. This means employers must disclose expenses for social security contributions. Basically you have two choices when it comes to the timing of disclosure.

Contributions are either

a) added to the stated compensation and disclosed together with the compensation on the date of allocation, or

b) disclosed separately from the stated compensation, and only stated in the year of the actual payment.

As the example described above shows, social security contributions can diverge considerably over time, especially since other facts besides the base value can change, for example contribution rates or the social security system applicable if the employee changes place of residence. To maximise transparency it would also be conceivable to combine the two options in the remuneration report by disclosing both the estimated social security contributions on granting of the compensation and the contributions actually paid on the compensation.

Not always the last word

shareholder rights are transferred.

**Say on pay:** The AGM’s say in retrospectively or prospectively determining the compensation of non-executive directors and executives.

**Short-term incentives (STIs):** Short-term components of compensation; usually refers to bonuses.

**Vesting period:** The period over which an employee accrues a benefit.
While the say-on-pay rules give the AGM a say in the compensation of management, they don’t necessarily mean the shareholders always have the last word. This is because the content of this kind of vote is also influenced by other binding requirements, such as employment law or the social security rules. For example if a key employee who has been granted a long-term incentive plan in a say-on-pay vote subsequently quits, this person is entitled to the compensation for the entire duration of their period of notice (generally a year for top management) even if they are relieved of their operational duties on the day they hand in their notice.

**Under scrutiny**

The remuneration report is subject to scrutiny by the auditors, although they only have to verify the information stipulated in Art. 12 to 14 of the VegüV/ORAb ordinance. This includes quantitative information on compensation, credits and loans. Qualitative aspects, such as the description of the company’s philosophy on compensation, compensation mechanisms and the processes for determining compensation, are not audited. Neither do the auditors have to give an opinion on the fitness of the compensation system in terms of its strategic relevance, or the appropriateness of the compensation paid. When conducting the audit, the auditors have to be aware that what are supposedly the same facts can be presented according to a variety of different rules. They have to make sure that in each presentation, the rules governing that particular approach have been complied with and implemented correctly. The auditors check whether the components of compensation covered in the remuneration report correspond to those laid down in the VegüV/ORAb ordinance, and whether they’re stated properly. For example, they verify whether the right people have been named in the right functions, or whether the number of people sitting on the executive board is correct.

**Little to criticise, plenty to explain**

Swiss companies limited by shares that have to comply with the VegüV/ORAb ordinance generally handle their compensation duties in compliance with the law. This seldom poses problems in terms of the audit. Typically for a first-time adopter situation, compensation is the subject of a great deal of public interest. Despite this, transparency remains a challenge, especially when it comes to presenting compensation systems with long-term components in a
comprehensible form. On the basis of initial experience over the last two years we will see the emergence of recognised practice with easily representable models.

Looking for answers

As described above, challenges emerge when you start looking at other questions relating to compensation, for example the disclosure of fees received by a non-executive director or executive on the basis of a consulting agreement. If the director or executive in question has entered into the consulting contract as a natural person and receives the fee directly or indirectly, it has to be disclosed as compensation paid to the director or executive in the remuneration report. If the consulting agreement is with a third party (an incorporated company or partnership), the disclosure requirement depends in the first instance on whether the third party counts as a related party. The EXPERTsuisse publication Ausgewählte Fragen und Antworten bei der Prüfung von Vergütungsberichten in Übereinstimmung mit der VegüV (revised edition of 18 August 2015) provides information on this and similar questions.

Summary

The remuneration report contains a clear and well-structured presentation of the way you deal with the compensation of your board of directors and executive management. Given that the issue is so sensitive, this requires a high level of transparency. You can meet the relevant requirements by striving for retrospective say-on-pay votes and simple models of compensation, producing your remuneration report in compliance with the VegüV/ORAb ordinance, and opting for detailed disclosure on an individual level. Complex systems can entail the inclusion of too much information and run the risk of being opaque. When producing your remuneration report you should be aware of any accounting distortions arising from different approaches. It makes good sense to clarify the implications of this for your annual report and financial reporting and to define the optimum presentation for your organisation.
In the spotlight: Corporate reporting

**Tax transparency: a wind of change sweeping the world of business**

The rules promulgated by the Organisation for Economic Co-operation and Development (OECD) and the European Union (EU) are creating greater transparency among corporations. They raise the question – which also arises for private individuals – of whether a business is making an appropriate contribution to the public coffers. This question is increasingly taking on a moral dimension. Calls for greater transparency are bringing about fundamental, permanent changes in the tax landscape. Most seriously affected are international companies.

Transparency and the cross-border exchange of information: these are the magic words that are supposed to prompt global companies to adopt new behaviour. But a distinction has to be made between two different issues.

- On the one hand there are various initiatives calling for **country-by-country reporting** of financial and tax-related information and the harmonisation of the rules governing transfer pricing documentation. This obliges companies to disclose more information, in greater detail, to the tax authorities, broken down by country. Country-by-country reporting is supposed to give an overall view of the global distribution of earnings and taxes paid by multinationals, and details of where their assets and business operations are located.

- On the other hand, **spontaneous or even automatic cross-border exchange** is giving tax authorities easier access to foreign tax information. The emphasis here is on exchanging details of tax rulings. The spontaneous exchange of information means that one tax authority spontaneously passes on information to another state because it suspects that the other
party might have an interest in the information – and not because it was explicitly requested. There may be foreseeable interest if the other state can use the information in question to apply and enforce its tax laws. The automatic exchange of information goes a step further: here tax authorities exchange information automatically on a routine basis (generally quarterly) in a predetermined form.

**Pressure from the OECD**

In recent years the OECD, under the aegis of the G8 and G20 nations\(^1\), has drawn up an action plan designed to prevent base erosion and profit shifting (BEPS). There are two aims behind the BEPS project.

- The first goal is to prevent international double non-taxation, especially of mobile income, by exploiting the tax rules in different jurisdictions.

- The second goal is to make sure that the profits of multinational corporations are taxed where they are generated.

On 5 October 2015 the OECD published its final report on the 15 BEPS actions and its recommendations. There will be additional instruments enabling the OECD to monitor the implementation of its BEPS action plan. Rather than being industry-specific, the actions are basically geared to all multinational companies. However, according to the OECD’s recommendations, country-by-country reporting should initially only be obligatory for multinationals with consolidated annual sales of at least EUR 750 million.

**Two actions requiring particular attention**

Two of the BEPS actions require special attention: the transparency rules governing country-by-country reporting and transfer pricing documentation (BEPS Action 13) and those governing the spontaneous exchange of tax rulings (BEPS Action 5).

- **Action 13** defines the content of country-by-country reporting and sets down the structure and content of transfer pricing documentation (consisting of two parts: master file and local files). The information companies have to disclose to the tax authorities on a country level includes related party and third
party sales, profit before tax, cash tax paid, headcount and main business activities.

It is up to legislators in individual countries to decide how to implement these requirements in national legislation. The OECD has not stipulated whether figures such as sales and profit before tax are to be calculated bottom up by aggregating the figures on the basis of audited statutory financial statements for individual entities, or top down by allocating IFRS group figures to individual countries.

- **Action 5** concerns the spontaneous cross-border exchange between tax authorities of tax rulings that relate to harmful tax practices or possibly contradict the principles and objectives of BEPS. For Switzerland the focus is on rulings deemed to be harmful for holding, auxiliary and mixed companies, and principal company rulings. Action 5 also describes how states should formulate their policy on rulings in the future.

**Legislators all over the world on board**

Parallel to the BEPS project the EU has amended its guidelines, which from 1 January 2016 will pave the way for the automatic exchange of rulings. Not only this, but all around the world national laws on transfer pricing and transfer pricing documentation are currently being amended and expanded. Swiss groups may also be affected by rules of this sort – indirectly at least if the rules impact their group companies abroad. The fact that the major economic locations are involved in BEPS should result in a more level playing field in global tax competition.

**Switzerland active for some time**

Like other OECD states, Switzerland is also having to make certain changes to the law and taxation practice to be able to implement the BEPS action plan. Some aspects have already been taken into account in the formulation of Corporate Tax Reform III, for example with the abolition of tax regimes for holding, auxiliary and mixed companies, and principal company rulings. Switzerland is also cooperating on the spontaneous exchange of information. At the end of 2013 it signed the OECD and Council of Europe’s Multilateral Convention on Mutual Administrative Assistance in Tax Matters, thereby undertaking to introduce the spontaneous exchange of information as set down in
BEPS Action 5. The Swiss tax authorities are to spontaneously exchange tax data from 2017 from 2018 on. In summer 2015 the Swiss Federal Council submitted the relevant dispatch to parliament to set the parliamentary debate on ratification of the convention in motion. Within the next three years or so a legal basis for country-to-country reporting should be established in Swiss law.

**A challenge for Swiss multinationals**

In many respects, implementing the BEPS project will be a herculean task for Swiss companies. The biggest challenge is likely to be the spontaneous exchange of rulings. Companies will have to answer a number of key questions: What rulings have been agreed in Switzerland and the rest of the world, and which ones are still in force? For which rulings are the tax authorities likely to exchange data? What information could reach which foreign tax authorities in this way? What are the implications, for example, in terms of the taxation of foreign group companies? Companies will also have to work out how to reformulate in BEPS-compliant wording, or how to divide information for exchange into relevant and irrelevant information. They might also have to think about how to switch from a ruling to a suitable alternative. When it comes to country-by-country reporting, the main challenges concern data acquisition and the related processes: Where can we get what figures, and how quickly? How secure are the sources of data? In evaluating and presenting these figures Swiss companies will see whether their group structure or transfer pricing have to be modified.

**Summary**

The wind of change is sweeping through the world of Swiss business in the form of developments in connection with tax transparency. This means that managers at multinational companies have to clarify the key questions in relation to country-by-country reporting and the exchange of tax rulings. Whatever the case, you will have to make any changes in your company before the end of 2016.

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1. G8: Group of the seven leading industrial countries plus Russia. The seven are Germany, France, Italy, Japan, Canada, the US and the UK. G20: Group of the 20 most important industrial and emerging nations, comprising the G8 countries plus Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, Turkey and the rest of the EU.
Non-financial reporting: responsible, far-sighted management

Non-financial reporting describes the way you deal with key themes that can have an impact on your organisation – including a financial impact. It involves a complex process of becoming aware and making aware. Becoming conscious of the consequences of your value creation, and explaining them to your stakeholders, is part and parcel of assuring long-term value and taking corporate responsibility.

Non-financial reporting is defined as disclosing information that isn’t based on the usual financial figures but which nevertheless gives your stakeholders an understanding of the essential areas of value creation in your business that goes way beyond your financial statements. Some intangible assets, for example, have their origins in a whole variety of non-financial performance indicators.

Vital for large organisations

Under the current interpretation, non-financial reporting is more relevant for large multinational companies than for small and medium-size enterprises (SMEs), although SMEs may be affected if they’re part of an area for disclosure because they’re involved in the supply chain of a global export or import company. On a global level the necessity of disclosing this kind of information depends primarily on the main cultural and economic considerations arising from the business that have to be covered in reporting.

Chequered past

Like so many global developments, the origins of non-financial reporting go back to unfortunate circumstances, in this case...
occurrences with an impact on the environment. Already decades ago events like Chernobyl and Schweizerhalle (1986) prompted tighter environmental legislation. Added to this, organisations have been under increasingly critical scrutiny from various quarters in relation to areas such as health and safety, compensation and the treatment of employees.

Shortly before the end of the millennium the Global Reporting Initiative (GRI) published its first sustainable reporting standard. Individual industries have created their own frameworks in parallel with this. The Verein für Umweltmanagement und Nachhaltigkeit in Finanzinstituten (VfU), for example, has set down environmental management and sustainability guidelines for banks, the European Chemical Industry Council (Cefic) has created a framework for chemicals, and the Cement Sustainability Initiative (CSI) launched by the World Business Council for Sustainable Development (WBCSD) has standards governing the cement industry. In Switzerland there have been repeated political and public initiatives to enshrine non-financial reporting in law, so far without success. The Swiss Federal Council’s ‘green economy’ proposal is currently being debated. The following institutions and guidelines play a significant role today:

- **UN Global Compact:**
  The ten principles of the UN Global Compact are derived from international frameworks in various areas including human rights, labour law, the Rio resolutions and the UN Convention against Corruption. The principles of the Compact are designed to provide organisations with a basis for acting with integrity.

- **UN Sustainable Development Goals:**
  The Division für Sustainable Development (DSD) promotes and implements the United Nations’ sustainability goals. Many organisations see these goals as a norm for taking account of societal dimensions in their sustainable development.

- **GRI-G4:**
  On the European level the fourth release of the GRI (May 2013) is regarded as the ultimate benchmark. GRI-G4 constitutes an indicative framework rather than binding legislation. At the core of the latest release is the principle of materiality (see Figure 1).

- **Integrated Reporting (IR):**
  On 9 December 2013 the International Integrated Reporting
Council (IIRC) published a framework for integrated reporting, the IR-Framework. This integral approach is designed to provide a holistic picture of the performance of an organisation and its various businesses.

- **EU directive** on the disclosure of non-financial and diversity information: These rules were given the rubber stamp by the EU Commission in April 2014 for adoption by member states in their domestic legislation. The directive is a principles-based standard for multinational companies with more than 500 employees, and gives users certain leeway. It applies to around 6,000 large undertakings and groups in the EU.

- **Sustainability Accounting Standards Board (SASB)**
  A counterpart to the Financial Accounting Standards Board (FASB), the Sustainability Accounting Standards Board (SASB) in the United States has set down standards requiring listed US companies to use Form 10-K, and non-US companies to use Form 20-F, for disclosure in standard filings to the SEC.

**Sustainability Accounting Standards Board (SASB)**

*Form 10-K, the standardised format specified by the Securities Exchange Commission (SEC) for annual reports, has to be submitted by companies with assets of more than USD 10 million. Form 20-F applies to all foreign issuers of securities that have shares listed on US exchanges.*

- **Principles for Responsible Investments (PRI):**
  The six UN principles provide guidance to enable the financial industry to ensure environmentally and socially compatible management. They centre around so-called ESG issues (Environmental, Social, and Corporate Governance).

- **Other principles for the financial industry:** Principles such as the Green Bond Principles, the Equator Principles or the Principles for Sustainable Insurance are used in the financial industry, particularly in connection with transactions or as a framework for setting investment objectives.
**Principle of materiality**

GRI-G4 places special emphasis on the principle of materiality in an attempt to prevent reporting from degenerating into a collection of data without any focus. Analysing materiality enables companies to first identify the key themes from the perspective of all their stakeholders, including authorities, local residents, suppliers and employees. Then they can define the areas where their business has a material economic, environmental or social impact. The approach covers the entire value chain, which means, for example, that because of its connections with certain suppliers a company might have to treat child labour as a material aspect even though the issue isn’t relevant in the company itself.

**Figure 1** shows how companies have to define materiality and communicate with the respective audience under the main frameworks and standards.

### Figure 1: Comparison of materiality under the main frameworks and standards

<table>
<thead>
<tr>
<th>Audience</th>
<th>&lt;IR&gt; (global)</th>
<th>IFRS (global)</th>
<th>GRI (global)</th>
<th>SASB (US)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Audience</strong></td>
<td>Providers of financial capital with a perspective on short, medium and long term</td>
<td>All existing/potential investors, lenders and other creditors</td>
<td>All stakeholders</td>
<td>Investors of those companies that engage in public offerings of securities registered under the Securities Act</td>
</tr>
<tr>
<td><strong>Subject matter / report purpose</strong></td>
<td>Value creation over time</td>
<td>Financial performance and position</td>
<td>Sustainability impact (economic, environmental, social, and governance)</td>
<td>Sustainability impact environment, social capital, human capital, business model and innovation, leadership and governance</td>
</tr>
</tbody>
</table>
| **Nature of definition** | Multistep process:  
- Relevant issues effect strategy, governance, performance, prospects and are discussed by board  
- Disclosure of material matters based on user need, and guiding principles | Information is material if omitting it or misstating it could influence decisions that users make based on financial information about a specific reporting entity. Relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity’s financial report. | Organisation-driven materiality  
The report should cover aspects that:  
- Reflect the organisation’s significant ESG impacts; or  
- Substantively influence the assessments and decisions of stakeholders | SASB is identifying a minimum set of sustainability topics that have a significant impact on most, if not all, companies in an industry and which – depending on the specific operating context – are likely to be material to a company within that industry; guided by the materiality definition adopted by U.S. Securities laws and case law |
| **Disclosure form** | Integrated report | Financial statements | Sustainability (GRI) report | For use in reports filed with the SEC |

**A question of responsibility**

Companies face a highly complex key question when it comes to non-
financial reporting: how can you communicate the non-financial assets that express your corporate responsibility? The answer is to be found in the organisation’s value chain. First of all you have to get absolute clarity on your productive activities and their implications for all your stakeholders. You have to understand what input (e.g. a raw material) results in what output (products or services) and ultimately what outcome (e.g. customer utility), who is affected by this and how. On the basis of this kind of matrix you can define the main fields of responsibility.

Non-financial reporting is a framework that enables you to mirror your key issues and initiate dialogue with your stakeholders – ideally regularly and systematically. So rather than simply being the result of the organisation’s own, internal ethical aspirations, responsibility reflects the impact of the organisation’s activities in terms of people and issues.

**Ambitious goals**

Transparency and communication are often named as goals of non-financial reporting. This is only partly true. Transparency is more of a result; it neither adds value nor safeguards against risks. And communication is a matter of getting the message across and choosing the right channel or format. The processes underlying and preceding non-financial reporting itself hone an organisation’s awareness of how long-term value can be created and the existence of the business can be assured. In concrete terms this means keeping an eye on risks and dependencies, making sure resources are available, maintaining the supply chain, and gaining and maintaining the trust of core audiences.

An organisation has to understand itself, be aware of its responsibility in all its complexity, and last, but not least, be understood by its stakeholders (see Integrated reporting). A business managed from this perspective is a business managed with far-sightedness and a focus on value.

**No guarantee**

Disclosing non-financial information is no guarantee you’ll be able to eliminate risks or errors. There are always risks over which an organisation has no control, or whose impact it underestimates. You can’t completely eliminate the risk of individual misconduct either. And of course there’s also the risk of errors in disclosure. Non-financial reporting isn’t an area where you can afford to think in
terms of black and white. When preparing and interpreting non-financial information, organisations, auditors and readers have to consider the context and the way the various influencing factors are linked. For this reason it’s seldom possible to compare different companies’ non-financial reporting one to one.

More clarity, more value

You might ask what benefits your organisation stands to gain from all this. That’s a valid question. Using non-financial reporting as a pure communications or marketing offensive is probably the least profitable approach. You’ll gain the most value if your non-financial reporting not only represents your business accurately and meets your own need for information and clarity, but meets the needs of your owners, the public, the media and your employees as well. You can also use non-financial reporting as a means of differentiating yourself from the competition. Whatever the case, it depends directly on your corporate culture and the philosophy of your board and management.

TIMM: measuring and managing impact

To translate non-financial information into financial impact we have developed a model called TIMM (Total Impact Measurement and Management) (see Figure 2). For the first time organisations can use various core indicators to assess the consequences of their actions in environmental, social, tax and economic terms. TIMM is a useful decision-making tool for managers. It helps you look at things from the perspective of materiality and broaden your understanding of your own products and services, which in turn feeds into risk management.
**Figure 2: TIMM (Total Impact Measurement and Management), PwC’s holistic framework**

<table>
<thead>
<tr>
<th>Total</th>
<th>Impact</th>
<th>Measurement</th>
<th>Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>View the social, environmental, fiscal and economic dimensions holistically - the big picture.</td>
<td>Look beyond inputs and outputs to outcomes and impacts – understand your footprint.</td>
<td>Quantify and monetise the impacts – value in a language business understands.</td>
<td>Evaluate options and optimise trade-offs – make better decisions.</td>
</tr>
</tbody>
</table>

**Definitely a job for the boss**

For historical reasons, at present non-financial reporting is generally left to the people in the organisation responsible for environmental and safety issues. But there’s a risk of tunnel vision or organisation blindness. We believe this type of disclosure is definitely a job for the board of directors and management. After all, it’s a question of the long-term development of the organisation. If you want to refine your reporting and keep it relevant – for example through multiyear...
storytelling – we also advise seeking an outsider’s view.

**Audit? Maybe**

Under Swiss regulations it’s not mandatory to have non-financial reporting audited. Naturally certain areas are scrutinised as a matter of course as part of the statutory audit. In France, the duty to have the disclosure of non-financial information audited is enshrined in law. But even audits of this sort won’t prevent a negative image or poor ratings, or mismanagement. Any information, financial or non-financial, that’s openly disclosed by management has to be reliable and credible. In other words, management should insist on the same standards of quality for non-financial information as it does for financial reporting.

**Summary**

Even though they’re not subject to full regulation, or only to partial regulation, non-financial issues can have financial consequences and lead to the creation or potential destruction of value. We advise strategic and operational managers at multinational companies to meet the challenge of non-financial reporting, define the material issues and goals of disclosure, and communicate these things transparently to the world outside. The ability to explain the impact of your business in terms of non-financial factors is a hallmark of professional, purposeful management, and non-financial reporting is a reflection of responsible entrepreneurship.

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1. Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups.
In the spotlight: Corporate reporting

**New auditor’s report: more transparency, more trust**

The new audit report, initiated by the International Auditing and Assurance Standards Boards (IAASB) in response to calls for greater transparency in the wake of the financial crisis, gives a thorough insight into the audit process. It is an opportunity for organisations to strengthen their reputation by providing additional information.

Have oversight bodies, controls and auditors all failed?

Many people were asking this question in the wake of the financial crisis as they tried to come to terms with what had happened. This uncertainty prompted the IAASB, the body responsible for the formulation and development of internationally recognised auditing standards, to overhaul the requirements for the auditor’s report.

**Transparency builds trust**

The main aim of the new report is to help close the expectation gap between the auditing firm and an organisation’s stakeholders, particularly investors. The extended coverage of the report and the additional information it provides are designed to present the material financial risks to which an organisation is exposed and explain the way these risks were addressed in the audit. The new report builds trust in the audit by forcing everyone involved to engage more closely with the auditor’s remit and how the audit is conducted.

**Straight talk from the IAASB**

As part of the reform project, the IAASB revised various International Standards on Auditing (ISAs) and stipulated diverse changes to the auditor’s report. The changes concern the structure of
the report (for example, the auditor’s opinion is now placed at the beginning) and the new components that have to be included. The big change is related to the so-called key audit matters (KAMs) assessed in the course of the audit. There is now a new ISA stipulating that these KAMs must be described in the auditor’s report for entities that have quoted equity or debt in their accounts, regardless of the financial reporting standards under which the financial statements for the individual entity or group are produced.

The new standard describes the background to KAMs and how they’re determined. Since the significant risks are contained both in the audit plan and in the comprehensive report to the audit committee and board of directors, the key audit matters are points that the management and audit committee are already aware of. KAMs must be described in the auditor’s report in such a way that the reader can perceive the associated risk from the auditor’s point of view. The entity’s point of view is also represented in the auditor’s report, by making reference to the corresponding note to the entity or group’s financial statements. Then the auditor draws an objective conclusion.

**Goodwill as a KAM – an example**

The following excerpt from the 2014 auditor’s report for the Sage Group (UK) shows the extent to which the external auditors might define goodwill as a KAM and address this in the audit.

**Goodwill impairment assessment**

We focused on this area due to the size of the goodwill balance (£1,433 million as at 30 September 2014), and because the directors’ assessment of the “value in use” of the group’s Cash Generating Units (CGUs) involves judgements about the future results of the business and the discount rates applied to future cash flow forecasts. In particular, we focused our audit effort on goodwill recognised in relation to the Brazilian CGU due to the impairment charge of £44.3 million recognised in the current year. The remaining goodwill balance related to Brazil is approximately £76.8 million. The Brazilian business was acquired by the group in 2012, but performance since acquisition has been impacted by a general deterioration in the macroeconomic
environment in Brazil, resulting in the current year impairment. The most significant element of the goodwill balance is that recognised on the two US CGUs, SBS and SPS, totaling £687.7m. Although, based on historical performance, the directors believe there is significant headroom between the value in use of the CGUs and their carrying value, this remained an area of focus for us as a result of the size of the related goodwill balance.

How our audit addressed the area of focus
We evaluated and challenged the composition of management’s future cash flow forecasts, and the process by which they were drawn up. In particular, we focused on whether they had identified all the relevant CGUs, including Brazil and the US. We found that management had followed their clearly documented process for drawing up the future cash flow forecasts, which was subject to timely oversight and challenge by the directors and which was consistent with the board approved budgets. We compared the current year actual results with the FY14 figures included in the prior year forecast to consider whether any forecasts included assumptions that, with hindsight, had been optimistic. Actual performance in Brazil was found to be lower than what had been expected and therefore management has reflected actual FY14 revenue growth rates and operating margins in this year’s model. We feel this judgment is appropriate given the past performance of Brazil. For all CGUs, and in particular, Brazil and the US we also challenged management’s assumptions in the forecasts for:

- Long term growth rates, by comparing them to economic and industry forecasts, and
- The discount rate, by assessing the cost of capital for the company and comparable organisations, as well as considering territory-specific factors.

We found the assumptions to be consistent and in line with our expectations. We challenged management on the adequacy of their sensitivity calculations over all their identified CGUs. We determined that the calculations were most sensitive to assumptions for revenue growth rates and discount rates. For all CGUs other than Brazil we calculated
The new and revised ISAs must be adopted by entities whose financial year ends on or after 15 December 2016. This includes all entities listed in Switzerland. The UK and the Netherlands have taken a pioneering role in this respect, with regulations already requiring application of the new reporting requirements for periods ending 2013 (UK) and 2014 (Netherlands). The response from organisations and investors in these countries has been very positive.

**KAMs: key to reading**

KAMs can include both financial and non-financial matters. Examples of non-financial KAMs include the IT systems or internal controls that are relevant to the financial statements. Key auditing matters of a financial nature can be found in areas such as goodwill, provisions, taxes and revenue recognition. Auditors determine KAMs on the basis of close dialogue with the decision-makers and people responsible at the client organisation, and on insights from previous years’ audits (see Figure 1).
The content should be presented objectively and as comprehensively as necessary. While it is not obligatory to draw conclusions about a KAM, it is advisable to do so because it gives readers key information and valuable input as the basis for their decision-making.

More to it, more in it

The new auditor’s report brings in many fundamental changes in terms of both form and content. As before, the structure is clearly laid down. However, it now has to be much more detailed and individual, because the report a) has to give a more comprehensive insight into the performance of the audit, and b) includes comments on the KAMs. In addition to the ISA, there is now legislation in the UK and the Netherlands requiring the inclusion of information on materiality and scoping, giving even deeper insights. We are working to have materiality and scope included in addition to a presentation of the audit approach in reports for Swiss listed companies, as this information creates much greater transparency. Figure 2 shows the new auditor’s report in schematic form, showing what elements have been retained, and what elements are new.
### Figure 2: The new auditor’s report: what elements have been retained, and what’s new?

<table>
<thead>
<tr>
<th>For all users of ISA</th>
<th>Only for listed companies</th>
<th>Additional voluntary disclosures only for listed companies</th>
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<tbody>
<tr>
<td>1. Opinion: focus on positive/negative overall opinion</td>
<td></td>
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<td>2. Basis for opinion</td>
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<td>3. Conclusions regarding going concern</td>
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<td>4. Responsibilities of management/ those charged with governance</td>
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<td>5. Auditor’s responsibilities</td>
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<td>6. Other legal requirements</td>
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<td>7. Signature with engagement partner’s name</td>
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<td>8. Key audit matters</td>
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<tr>
<td>9. Key audit input judgements, including materiality and group scoping</td>
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</table>

#### Old components of the auditor’s report
- Opinion
- Basis for opinion
- Conclusions regarding going concern
- Responsibilities of management/ those charged with governance
- Auditor’s responsibilities
- Other legal requirements
- Signature with engagement partner’s name

#### New (additional) components of the auditor’s report
- Key audit matters
- Key audit input judgements, including materiality and group scoping

### More information, more discussion

The new auditor’s report has to be published in full, regardless of whether a Swiss entity reports under IFRS, US GAAP or Swiss GAAP FER. Because it is more comprehensive, the report will create a certain amount of extra work for management, who will now have to engage more closely with the significant risks mentioned above as well as materiality and scope. This discussion will continue to take place behind closed doors – however now the auditors will communicate the outcome of the debate in their report. It is very possible that management will have to provide stakeholders with answers to more questions in the future. The best way of preparing for this is to start taking an in-depth look at the scope and content of
the audit early on.

**A boost for the audit**

Investors have great expectations of the audit. By the end of 2016 at the latest, the new auditor’s report will be having a positive impact on the audit. International experts believe that the new report will make it significantly easier to understand an entity’s economic position, building trust both inside and outside the organisation. The IAASB’s aim is for the greater transparency provided by the report to boost understanding in terms of the objectivity and reputation of the audit.

**Where does Switzerland stand? What questions remained unanswered?**

In Switzerland the design of the auditor’s report is set down in the Swiss Auditing Standards. These standards, the result of intensive dialogue between the association of auditors (EXPERTsuisse) and the auditing firms, represent the implementation of the ISAs in Switzerland. We can expect to see different auditing firms adopting different approaches in the areas of reporting (materiality, scope and conclusions) that are voluntary under the ISAs. EXPERTsuisse is also in the process of evaluating whether reporting on KAMs subverts the auditors’ duty to maintain confidentiality. The Federal Audit Oversight Authority (FAOA) has now issued a circular that declares that the new auditing standard for listed companies is applicable for periods ending on or after 21 December 2016. Early adoption for the 2015 financial year is also possible. These new regulations mean that Switzerland is proceeding more quickly than Germany, where the new ISA isn’t due to be implemented until 2017.

«We at PwC are committed to implement the amended and new ISAs to build public trust in the audit. Besides information on the audit approach, our auditor’s reports will also cover materiality and scoping. Our aim is to present KAMs as specifically as possible and draw objective conclusions. This way we will actively help organisations

We’re at your service!»

Joanne Burgener
Partner, Assurance
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**Summary**

The implications of the new auditor reporting requirements for listed companies go beyond merely redesigning the report. They’re a great opportunity to build reputation and trust in your organisation. When implementing the requirements we recommend going into as much concrete detail as possible in the report, as this creates more transparency and gives added depth to management’s engagement with the audit. To this extent, we truly believe the new report constitutes a revolution in auditing.
Handling business information: it’s well worth a rethink!
by Christian Hug – page 67

Derivatives trading: how the FMIA will impact entities outside of the financial services sector
by James Nelson – page 76
Update

Handling business information: it’s well worth a rethink!

The digital revolution is affecting our daily lives and unleashing a torrent of information. By taking a strategic approach to handling documents and data of all types you can make sure information is managed, used, stored and deleted appropriately. An approach like this is an effective tool that will enable you to find, process and use information in digital, electronic or physical form rapidly and efficiently. But let us be honest: who can claim that is what really happens in their organisation?

Business documentation, data and information are crucial to the success – and even the survival – of your organisation. They are the means by which you manage and control your business, develop products and services, identify risks and opportunities, and meet accounting and reporting requirements and other legal requirements relating to things like product warranties. With authentic, unimpaired information at your fingertips you can assert your position even in difficult situations such as legal proceedings. Last but not least, proper information can help you boost productivity, efficiency and flexibility. These days it is not just about archiving, but the way you handle information in general. You need to classify information. Information is a precious asset and the key driver of your success, so you have to safeguard and use it correctly, bundling the entire knowledge from across your value chain, including research, development and production activities, services, partners and customers.

Meeting more stringent requirements

The way the legal requirements with regard to handling information are put into practice still varies a great deal – and it is not always in compliance with the law. With increasing calls for transparency and a
growing number of laws, your stakeholders are getting more and more demanding. Customers want to be able to buy tailor-made products and services while at the same time reaping the fruits of innovation. The authorities expect proof that you are complying with the relevant rules and regulations and society demands sustainable, trustworthy behaviour. For your part you want to improve the efficiency and effectiveness of your organisation, focus on the essentials, and create competitive advantage.

**Identifying the things that bring success**

As a decision-maker and the person who ultimately bears responsibility, you have to take the business view: to move forward you have to make things quicker, more efficient and straightforward. With your business locations spread around sites in different geographic locations it becomes harder to collaborate efficiently, especially if your processes are time-consuming and paper-based. To make sure information is available in real time, you need to automate these processes and replace them with electronic processing, filing and storage systems – which also means digitising relevant information in paper form. That is the only way of remaining agile in the marketplace. To do this you have to see the handling of business information as an integral part of your business processes and define clearly how you deal with relevant information both inside and outside your organisation. If you can take a 360 degree view and establish it within your organisation, taking control of your documents and data, you will gain a key edge in the marketplace by way of greater efficiency, transparency and trust.

**Complex challenge**

Successfully handling business information involves an interplay of technologies, front and back office business processes, and compliance (see Figure 1). Your business faces a whole series of challenges in these three areas. What they all have in common is that they require you to rethink the way you view and deal with information.
Technologies: keeping up with the digital revolution

In recent years it is not only information that has been digitised; entire business processes, communications channels and the (automatic) exchange of information with external stakeholders have moved into the digital realm. For example you may now require suppliers to send invoices and receipts electronically (e-invoicing), and these days official documents (even notarised documents) are often delivered electronically.

Proof of compliance with regulatory and financial reporting requirements now also has to be provided in electronic form. The challenge for you is to validate, process, archive and delete this information. Since the validity of this proof can only be verified electronically, you can no longer store it in physical form. For example, electronic bills lose their validity once you print them out.

The pace of digitisation is reflected in the way new technologies, systems and services are developed and refined. At the same time there has been a radical change in the way information is used, meaning that technology now has to keep up with growing mobility and ensure perfect continuity between different media. At the same time you need to make sure all this is in compliance with the relevant legal requirements, for example the data privacy rules.

The information life cycle is not just determined by your core business; it is also influenced by associated processing and decision-
making processes. For this reason you need to evaluate new technologies and systems such as the cloud and deploy them systematically. Often you will find your entire business and IT architecture is up for discussion. You have to replace old systems, applications and functions, and introduce new ones in line with the requirements of your business and the law.

**Safeguarding integrity**

*The Swiss Accounts Ordinance (Verordnung über die Führung und Aufbewahrung der Geschäftsbücher, GeBüV) stipulates that you must be able to demonstrate the integrity, legibility and traceability of records and data that are subject to compulsory retention. You must make sure that your information remains in its original state, i.e. complete and accurate, for the entire statutory retention period. This is just one of the tasks facing your compliance department.*

**Business processes: redesigning workflows and information cycles**

The digital revolution forces you to rethink the way you handle information. You have to ask yourself what information should be digitised and what business processes automated. This way you can free up your staff to focus on the essentials and prevent a disproportionate rise in the costs of administration, storage and searching. To an increasing extent, transactions are being settled electronically. This means that you must record the conclusion of the contract and the conditions applicable at the time electronically so that they can be reconstructed. To get on top of these challenges you should manage the information life cycle and recognise the interdependencies (see Figure 2). It is therefore imperative to formulate and implement a document management and archiving strategy for your organisation. This is the only way of making sure you can find relevant information and capitalise on it. Modern and efficient document and data management starts at the moment information is generated or captured.
Compliance: keeping to rules and regulations

One of the main challenges is to comply with the numerous rules and regulations and keep up with the changes – especially if you operate in countries with different legal requirements. If information is relevant in legal or regulatory terms (accounting, VAT, customs, data privacy, etc.) you also have to make sure it is complete, intact, readable and trackable throughout the entire life cycle. Here there are often special procedures in place such as electronic signatures and encryption technology, especially if information is transmitted across borders.

Beware of risks and the unintended consequences of non-compliance

If you fail to comply with legal or regulatory requirements you risk the following:

- Fines and prosecution
- Forfeit of the right to deduct input tax (VAT) on supplier
By managing your business documents and data in compliance with the relevant laws and regulations you will avoid the cost of having to implement requirements or conduct searches in response to official enquiries. In our experience, a failure to consistently store documents and data can result in heavy costs – for both internal and external personnel – in the event of enquiries from the authorities or internal reviews (e-discovery).

**Complex solution**

These days an appropriate approach to handling business information means actively managing documents and records with the help of systems, exploiting sources of data, and maintaining the relevant IT systems and processes to manage and bring together this information compliantly – from data capture and storage to deletion. Smart information management involves more than mere archiving, but is a lot more valuable as well.

**More than just one law**

You will find an overview of the relevant legal texts here. In Switzerland the management and archiving of business information is governed primarily by the provisions of the **Swiss Code of Obligations** on commercial accounting (Art. 957-963 CO) and the accounts ordinance (Verordnung über die Führung und Aufbewahrung der Geschäftsbücher, GeBuV). In addition to this basic framework there are diverse special provisions in other areas of the law. The **Ordinance of the FDF on Electronic Data and Information** (OEIDI), for example, regulates the transmission of electronic invoices. The **Federal Act on Data Protection** (FADP) is particularly relevant when it comes to archiving data on servers outside Switzerland and working with outsourcing services. The **Tax Act** also

- Revocation of reduced VAT rates on customer invoices
- Damage to your reputation
- Lack of proof (to your detriment) in legal proceedings
- Loss of licences and market access
contains rules on the retention of data. The Anti-Money Laundering Act and Gambling Act contain special rules governing the retention of industry-specific documents by financial intermediaries and casinos. Banks also have to take account of SwissBanking’s Guidelines on Dormant Assets.

**Proceed in steps**

Many organisations are put off by the expense and effort involved in implementing a coherent information governance system. But you do not necessarily need to implement a completely new model at all your sites and in all areas of your business. Merely by redesigning or streamlining individual processes or phases you can gradually create clear advantages. Figure 3 shows one possible approach.
Figure 3: Seeing information governance as a way of adding value rather than just as extra work and expense

1. Gap analysis
You define the goal you want in terms of handling business information, taking account of all the relevant stakeholders and finding out their requirements. This analysis enables you to find gaps between the current situation and your goal.

2. Strategy and approach to a solution
You formulate a coherent strategy for managing business information on the basis of the gap analysis and a survey of internal and external factors such as your business and organisation structure, information flows and life cycles, security, IT and stakeholders. You follow these approaches to gradually close the gaps and optimise your business processes.

3. Compliance requirements
You identify the legal and regulatory requirements relevant for you. These requirements will have a decisive influence on the way you handle information and its quality, for example in terms of integrity and readability, protection from harmful influences, traceability and authenticity, usability and availability.
It pays to be cautious, especially when interpreting these requirements and their implications for your organisation. Here it can make sense to seek outside support.

4. Concept
Before you start executing strategies and solutions you need a basic and detailed concept. Your concept revolves around defining responsibilities and the planning of gradual implementation to ensure your project achieves the defined goals. At this point you should look at cultural change and train your staff.

5. Realisation
To successfully implement your detailed plan you should reduce the complexity with the help of interim goals and milestones, and proceed with implementation step by step. This phase revolves around making structural adaptations to systems and optimising processes.
To keep track of all the complexity, it makes sense to continually refer to the gap analysis, your strategy and the relevant internal and external requirements. You might have to repeat phases 1 to 4.
Changing your way of thinking

It is true that implementing the technology and processes necessary for modern information governance is a complex and challenging undertaking. The desire to involve all areas of the business and tick all the boxes makes it even more complex. However, the most difficult task you will face is establishing a new cultural outlook within your organisation – a culture that views information governance as a rich opportunity rather than an onerous chore.

Summary

Handling information relevant to your business means taking a holistic view of information encompassing the entire value chain, all the relevant legal and regulatory requirements, and the various areas of your business. So it is much more than merely archiving documents and data. These documents and data are primarily digital and involve the entire information life cycle from data capture and generation to timely provision and storage and deletion. If you have the relevant business information in hand you will find yourself with more efficient and effective processes and IT systems, optimum compliance and risk management, lower costs, and a lasting advantage over your competitors.
Update

Derivatives trading: how the FMIA will impact entities outside of the financial services sector

New regulation is on the horizon for Swiss firms trading in derivative financial instruments. The upcoming Swiss Financial Market Infrastructure Act (FMIA) will not only affect the financial services industry, but also other Swiss entities trading in derivatives.

Regulatory shifts are under way as Switzerland moves to align more closely with the international community. On 19 June 2015, parliament enacted the FMIA, also known as FinfraG (Finanzmarktinfrastrukturgesetz). Effective from the first of January 2016, the new legislation establishes rules similar to those of the European Union (European Market Infrastructure Regulation, EMIR) and the United States (Dodd-Frank Act). In 2009, the G20 published procedures for regulating derivatives trading in an effort to reduce the risk of market instability. EMIR was subsequently enacted in 2012 by the European Commission. As the majority of derivative transactions in Switzerland are with counterparties in the European Union, the enactment of the FMIA is intended to converge the related regulatory environments with the aim of reducing systemic counterparty risk and ensuring the transparency of derivatives markets. The move will help to preserve transparent access to international markets. It also presents an opportunity for the affected firms to reassess the maturity of existing risk management systems. Transitional periods have been set for the implementation of the new standard. The first obligation under the FMIA will require written documents setting forth how entities will implement the FMIA by January 1, 2016. Other obligations will enter into force in subsequent phases.
Affected institutions

The new legislation broadly applies to all entities which have a registered office in Switzerland, and which trade in derivative financial instruments. Firms will fall into one of four counterparty classifications (see Figure 1) depending on the type of business and the volume and nature of derivatives trading. These categories, in turn, will determine which requirements of the FMIA the business will be subject to.

**Figure 1: Categories under the FMIA**

<table>
<thead>
<tr>
<th>Financial counterparty (FC)</th>
<th>Small financial counterparty (Small FC)</th>
<th>Non-financial counterparty (NFC)</th>
<th>Small non-financial counterparty (Small NFC)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisations trading in derivatives that are categorised as Swiss domiciled banks, securities dealers, insurance and reinsurance companies, parent companies of a financial or insurance group or financial or insurance conglomerate, fund management companies, asset managers of collective investment schemes, collective investment schemes, occupational pension schemes and investment foundations.</td>
<td>Financial counterparties that carry less than CHF 8 billion in open derivative contracts, as measured by the average gross notional of open positions over the preceding 30 working days. Intrtragroup over-the-counter (OTC) transactions are included when assessing this threshold for entities that are part of a fully consolidated group.</td>
<td>All legal entities that do not qualify as financial counterparties.</td>
<td>Non-financial counterparties with less than CHF 1.1 billion in average gross notional of open credit and equity derivatives, and less than CHF 3.3 billion in average gross notional of foreign exchange, interest rate and commodity derivatives, as calculated over the preceding 30 working days. Intrtragroup OTC transactions are included when assessing this threshold for entities that are part of a fully consolidated group. Derivative transactions intended to reduce risks may be excluded when assessing these thresholds if they are directly associated with the business activity, liquidity management or asset management of the counterparty or group.</td>
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An entity can generally determine its classification under the standard as shown below. However, as the standard presents certain nuances in making this determination, entities may find it helpful to speak with an expert.
**Definition of a derivative under the FMIA**

The standard broadly defines derivatives as financial contracts which are not spot transactions, and for which the value is derived from an underlying factor (such as an interest rate, foreign exchange rate or commodity price index). Derivative contracts relating to electricity and gas are, under certain conditions, excluded from the scope of this definition. The law further excludes structured products, repurchase and securities lending transactions, warrants, and contracts resulting in the physical settlement of goods. This last exemption is particularly important for Swiss entities outside the financial services sector. For example, a company that trades in timber using lumber forward contracts would be exempted from the provisions of the FMIA for this type of business, provided that the forward contracts result only in physical delivery.

**Actions by management of small non-financial counterparties**

The vast majority of Swiss entities outside the financial services
sector will be classified as small non-financial counterparties, and will be subject to comparatively few of the legislation’s requirements, which are discussed below. The management of a small non-financial counterparty is charged with having processes and controls in place to allow the entity to meet several performance requirements.

- **Reporting:** Except for those between two small non-financial counterparties, all exchange traded and OTC derivatives transactions are required to be reported to a trade repository authorised or recognised by the Swiss Financial Market Supervisory Authority (FINMA). This also applies for intragroup derivatives. In contrast to EMIR, only one of the counterparties is required to report under the FMIA. A hierarchy is prescribed in the standard to determine which counterparty in a deal is required to report, under which the reporting party would normally not be a small non-financial counterparty. In some situations, however, for example when the counterparty to a trade is not subject to the FMIA, a small non-financial counterparty may become the reporting party.

- **Risk mitigation:** OTC derivatives (excluding currency swaps and forward transactions) which are not cleared via a central counterparty, are subject to risk mitigation requirements. The requirements applicable to small non-financial counterparties include (i) confirming the contractual terms of derivative transactions with counterparties, (ii) having procedures in place to recognise and settle disputes with counterparties at an early stage and (iii) compressing portfolios at least semi-annually if they hold more than 500 open non-centrally cleared OTC transactions. Small non-financial counterparties are exempt from the requirement to value open derivative positions on a daily basis, as well as the requirement to exchange collateral with counterparties.
Significance for Swiss Firms

Is your organisation fit for the FMIA?
The FMIA will mean different things to different organisations. As we have witnessed from the enactment of EMIR within the European Union, firms will benefit greatly from starting their impact assessment and the implementation of solutions early on. Small non-financial counterparties will find that, in most cases, reporting obligations for derivative trades will be borne by the counterparty. These organisations will nevertheless need to identify any potential reporting duties and meet operational risk management standards, including the confirmation of contractual terms with counterparties, having risk management and dispute resolution procedures in place, and compression of larger portfolios. Smaller organisations may find that a health check of their existing policies and practices is a sufficiently pragmatic response. Auditors of small non-financial counterparties are additionally required to audit an organisation’s compliance with the FMIA, and to report their results to the board of directors. Companies are encouraged to engage their auditors in their solutions, and to discuss their corresponding assurance needs.

Summary
Assurance providers may provide valuable insight into a company’s roadmap to compliance, as they will ultimately be required to report on each company’s compliance with the standard. Is your organisation fit for the FMIA?
1. Portfolio compression reduces the aggregate notional of open derivatives, thereby reducing counterparty risk. Portfolio compression is achieved when two or more counterparties contribute derivatives to a portfolio which is terminated and replaced by a surviving derivative contract with a lower notional value than the aggregate notional of the previous instruments.
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