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Review of practical implementation issues relating to international financial reporting standards

Case study of Switzerland**

Executive Summary

This case study presents the context, application and enforcement of international financial reporting standards (IFRS) in Switzerland. It begins with an introduction to the Swiss legal framework by presenting the requirements for accounting, reporting, and auditing. It then examines the application and enforcement of IFRS in Switzerland, particularly for listed companies. It concludes with a summary and an overview of expected amendments to the legal framework. The study notes that the regulatory framework for financial reporting in Switzerland is oriented towards the protection of creditors. International exposure and a need to raise external capital motivated Swiss entities to implement International Accounting Standards (IAS) on a voluntary basis and provide consolidated financial statements. The study shows that, between 2001 and 2007, the number of entities listed on the Swiss Exchange that prepare their annual reports on the basis of IFRS grew from 155 to 191. In 2007, out of a total of 262 companies listed on the Swiss Exchange, about 73 per cent prepared their financial statements in accordance with IFRS. For 2007, the key areas of focus for enforcement of IFRS for the Swiss Exchange relate to: financial instruments disclosure; accounting policies; income taxes; related party disclosures; and intangible assets from business combinations.

* ISAR documents were previously issued under the symbol TD/B/COM.2/ISAR/...

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I. Background

1. In view of the widespread adoption of international financial reporting standards (IFRS) in recent years, UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been reviewing practical issues that arise in the course of implementing IFRS, with a view to facilitating the sharing of experiences and lessons learned among member States. At its twenty-second session, ISAR deliberated on a background note (TD/B/COM.2/ISAR/28) prepared by the UNCTAD secretariat which highlighted major practical implementation issues pertaining to institutional and regulatory arrangements, enforcement mechanisms, technical issues and capacity-building. On the basis of this framework, country case studies covering Brazil, Germany, India, Jamaica and Kenya were prepared and considered at the twenty-third session of ISAR. Furthermore, country case studies of Pakistan, South Africa and Turkey were discussed at ISAR's twenty-fourth session.

2. In concluding its twenty-fourth session, ISAR requested the UNCTAD secretariat to continue conducting studies on practical implementation issues relating to IFRS, including on related topics such as implementation of international standards on auditing (ISAs). Accordingly, country case studies on practical implementation of IFRS covering Egypt, Poland, Switzerland, and the United Kingdom – as well as a study on practical challenges and related considerations in implementing ISAs – were prepared for consideration by the twenty-fifth session of ISAR. The main objective of these papers is to facilitate sharing of experiences among member States.

3. This note presents the findings of the case study conducted in Switzerland. It discusses key regulatory provisions in Switzerland regarding accounting, financial reporting and auditing. It illustrates practical implementation of IFRS in Switzerland. The study provides insights into key issues that arise in the implementation and enforcement process.

II. Introduction

4. Switzerland is a highly industrialized country based upon a free enterprise economy. Tourism, commerce, banking and insurance have become significant elements in the Swiss economy and have a high degree of international interdependence. Switzerland was a founding member of the European Free Trade Association (EFTA). EFTA countries are associated with the European Union (EU) in many areas. However, Switzerland does not belong to the EU or the European Monetary System.

III. Legal requirements regarding financial reporting and auditing

5. Most business activity in Switzerland is conducted by limited liability companies, which have predetermined capital that is split into shares. Only the limited liability company's capital is liable for its commitments. Some 175,000 of these companies were listed in the commercial register at the end of 2006.¹ Over 99 per cent are privately owned, most of them by a single shareholder, whereas about 300 list their shares on a stock exchange (mainly the SWX Swiss Exchange);²

¹ http://www.bfs.admin.ch/bfs/portal/de/index/infothek/lexikon/bienvenue_login/blank/zugang_lexikon.Document.20935.xls (as of 6 June 2008).

² http://www.swx.com/monthly_reports/productive_env/2008/05/Mb_swx_stat_200805.pdf (as of 20 June 2008).

A. The Swiss financial reporting system

6. Switzerland has a system of codified law typical of continental European countries. Corporate law is based on the Code of Obligations. As in most continental European countries, Swiss accounting regulations are derived from the Napoleonic Code and have also been influenced by German law. These regulations impose certain requirements on all companies that are geared towards the protection of creditors. Continental European countries, especially Switzerland, have traditionally emphasized prudence as a key accounting concept underlying their legal accounting framework. Separate annual financial statements are the basis for determining taxes, since tax authorities use similar recognition and measurement principles and values as those applied in financial statements.

7. In Switzerland, accounting and reporting requirements differ depending on an entity's legal form within Swiss civil law. The most extensive requirements relate to limited liability companies, which are discussed below.

B. Accounting in accordance with the Code of Obligations

8. Establishing a limited liability company requires entry into a cantonal commercial register. All companies in the commercial register must comply with the general accounting records requirements embodied in articles 957–963 of the code. More stringent rules apply to limited liability companies (arts. 662–677).

9. The board of directors of a limited liability company must prepare a business report for each year. It consists of the audited separate financial statements, the annual descriptive report and the audited consolidated financial statements, if such statements are required by law. The statutory separate and consolidated financial statements include an income statement, balance sheet and notes.

10. Separate financial statements must be prepared in line with generally accepted accounting principles. The following creditor-oriented principles should be taken into account:

- (a) Completeness
- (b) Clarity and materiality of disclosures
- (c) Prudence (conservatism)
- (d) Going concern
- (e) Consistency in presentation and valuation
- (f) Prohibition of offsetting assets and liabilities, as well as expenses and income.

11. These principles are specified by development of theory and common practice and are not detailed in the law.

12. Separate financial statements should offer a reliable picture of the income and financial situation of the company. However, the existing statutory and tax regime permits the creation of hidden reserves, which the law encourages as a means of providing finance and avoiding undue variations in dividends. Hidden reserves are not disclosed in the statutory accounts: only when they are released must the net amount of hidden reserves released be disclosed.

13. Separate financial statements are used to determine the distribution of profit and over-indebtedness (art. 725) and for assessing both income tax and capital tax. Therefore, they must be produced according to generally recognized commercial principles. On the other hand, separate or individual financial statements drawn up in accordance with IFRS would not be compatible with legal requirements (e.g.

unrealized gains on financial assets are not recognized under company law) and therefore would represent a breach of these requirements.

14. Company law prescribes when consolidation has to take place. There is a duty to consolidate in case of a majority of votes or control by other means, having one or more companies under uniform direction (art. 663e). Exceptions apply to intermediate holding companies and in circumstances where a company and its subsidiaries do not exceed two of the following criteria in two consecutive financial years:

- (a) Total assets of 10 million Swiss francs (SwF)
- (b) Revenues of SwF 20 million
- (c) A yearly average of 200 full-time employees.

15. Consolidated financial statements still have to be prepared if:

- (a) The company has bonds outstanding
- (b) The company's equity securities are listed on a stock exchange
- (c) Shareholders holding at least 10 per cent of share capital request them
- (d) A reliable picture of the income and financial situation of the company can only be obtained by way of a consolidation.

In practice, there are approximately 1,500 companies that are required to prepare consolidated accounts.

16. The rules governing the preparation of consolidated financial statements (art. 663g) are very limited, incorporating only a reference to the generally accepted accounting principles set out in article 662a of the Code of Obligations. An entity is required to disclose in the notes to the consolidated financial statements the specific consolidation methods and valuation principles applied. As consolidated financial statements are not used for profit distribution and are irrelevant for tax purposes, a company may deviate from statutory accounting requirements by applying a set of standards which provides a true and fair view (fair presentation). Therefore, IFRS as well as other standards resulting in a true and fair view may be applied to fulfil the legal requirement for consolidated financial statements. As a result of this liberal accounting framework, many Swiss companies listed on the SWX Swiss Exchange have applied the International Accounting Standards (IAS)/IFRS for many years and long before the standards were introduced in the EU.

17. In general, the public has limited access to financial statements of Swiss companies since there is no requirement to publish or file them with the commercial register. The only exceptions are listed companies, banks, insurance companies and mutual investment funds. As only about 300 companies are listed, extremely limited information is available on all other companies, including the 175,000 limited liability companies whose accounts are not open to the public.

18. Given that only public companies must disclose financial statements, there are few sanctions that can be placed on a company that fails to prepare proper financial statements. The main articles of the Swiss Penal Code relating to accounting and accounting records are:

- (a) Article 146 "Fraud"
- (b) Article 152 "False information on businesses"
- (c) Article 163 "Fraudulent bankruptcy"
- (d) Article 166 "Negligent maintenance of accounting records".

There have been only a few court decisions in these areas, mostly relating to bankruptcy cases and tax fraud.

C. Auditing provisions in Switzerland

19. Auditing requirements are found mainly in articles 727–731a of the Code of Obligations. Auditors have to confirm acceptance of their engagement in writing to, and are elected by, the general assembly of shareholders (annual general meeting). The letter of acceptance must be filed with the commercial register, which makes this information public. Under article 730a of the code, the maximum term of the engagement is three years. However, re-election is possible. An auditor may resign at any time and must communicate the reasons to the board of directors. Under article 663b (13) of the code, the board of directors must disclose in the notes to the statutory financial statements why an auditor resigned. An auditor may be replaced at any time by the annual general meeting.

1. Auditors (Admission and Oversight) Act

20. The Auditors (Admission and Oversight) Act governs the admission and oversight of persons providing auditing services. It is intended to ensure that auditing services are provided properly and that they meet certain quality standards. There are two implementing ordinances (Ordinance on the Admission and Oversight of Auditors and the Ordinance on the Supervision of Audit Firms) and one circular relating to the recognition of auditing standards that specifies the requirements of the Act.

21. To be able to provide auditing services, individuals must be licensed by the Federal Audit Oversight Authority. Different professional qualifications and independence requirements apply to auditing bodies depending on whether public companies (as defined in art. 727 of the Code of Obligations) are being audited or another ordinary or limited statutory examination is performed.

22. Individual persons must have a spotless record and fulfil certain requirements regarding education and professional practice in order to be licensed as audit experts or auditors (art. 4 of the Act). Licensed audit experts are, in general, Swiss-certified accountants. Audit firms will be licensed as audit experts if the majority of the members of its highest supervisory and executive bodies, at least one-fifth of the people who provide audit services and all people who lead audit services have obtained the necessary licence (art. 6 of the Act). Furthermore, audit firms providing auditing services to public companies are subject to State oversight, which is performed by the Federal Audit Oversight Authority (art. 7 of the Act). Audit firms that want to provide such services must fulfil the requirements for licensure as audit experts, ensure that statutory requirements are met and have sufficient insurance against liability risks (art. 9 of the Act and art. 11 of the Ordinance on the Admission and Oversight of Auditors). Duties for audit firms under State oversight relate to independence, quality assurance, information and access to premises and communication with the Federal Audit Oversight Authority (arts. 11–14 of the Act).

23. The authority publishes a list of licensed audit experts and auditors on its website. If a person no longer fulfils licensing requirements, the authority may withdraw his or her license for a specific or undetermined period of time (art. 17 of the Act). If an audit firm under State oversight no longer fulfils licensing conditions or repeatedly or grossly violates legal provisions, the authority may withdraw its licence.

2. Auditing in accordance with the Swiss Code of Obligations

24. A distinction is made for all entities (independent of their legal form) between ordinary audit, limited statutory examination and no audit requirement. "Ordinary audit" is the Swiss legal term for audit.

25. The requirements of an ordinary audit and those of a limited statutory examination, (which follows a review-based methodology) can be compared below:³

Table 1. Ordinary audit and limited statutory examination requirements

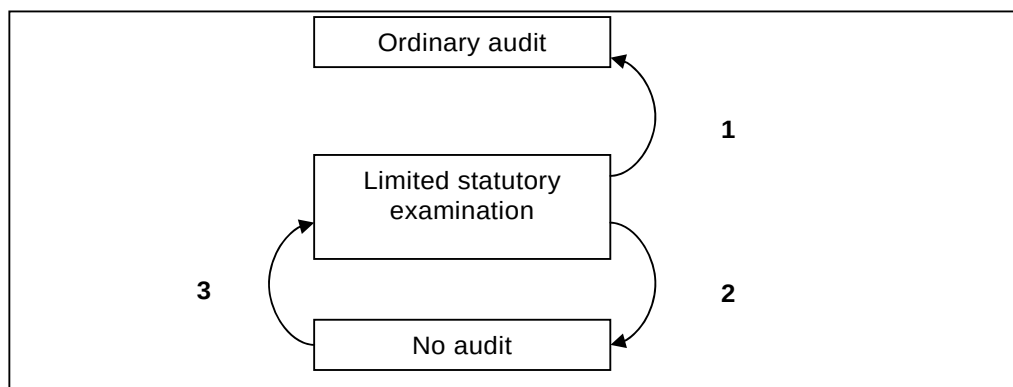
	Ordinary audit	Limited statutory examination
Application (arts. 727 and 727a of the Code of Obligations)	(a) Public companies: (i) Shares listed on a stock exchange (ii) Bonds outstanding (iii) Companies that contribute at least 20 per cent to assets or revenues in the consolidated financial statements of companies that have shares listed or bonds outstanding (b) Entities that exceed two of the following criteria in two consecutive financial years: (i) Total assets of SwF 10 million (ii) Revenues of SwF 20 million (iii) A yearly average of 50 full-time employees (c) Entities that must prepare consolidated financial statements	In general, all entities that are not subject to an ordinary audit
Professional requirements (arts. 4–9 of the Auditors (Admission and Oversight) Act)	(a) For auditing services provided to public companies: auditing firm (licensed audit expert) under State oversight (b) For all other ordinary audits: licensed audit experts	Licensed auditors
Audit scope (arts. 728a and 729a of the code)	(a) Separate financial statements (b) Consolidated financial statements (c) Proposal of the board of directors relating to the appropriation of earnings (d) Existence of internal control system	(a) Separate financial statements (b) Proposal of the board of directors relating to appropriation of earnings
Scope of examination (arts. 728a and 729a of the code)	Comprehensive audit based on legal and statutory requirements, as well as Swiss Auditing Standards that are broadly in line with international standards on auditing	Brief, limited to specific audit procedures such as queries, analytical audit procedures and appropriately detailed tests in line with legal and statutory requirements ./...

³ <http://www.admin.ch/ch/d/ff/2004/3969.pdf> (as of 20 June 2008).

	Ordinary audit	Limited statutory examination
Communication (arts. 728b and 729b of the code)	(a) Comprehensive report to the board of directors with findings on financial reporting, internal control system and the performance and results of the audit (b) Audit opinion to the general meeting of shareholders about the result of the audit, including positive assurance: “The financial statements comply with Swiss law and the company’s articles of incorporation ...”	Review report to the general meeting of shareholders about the results of the limited statutory examination, including negative assurance: “... we have not come across any facts which would lead us to believe that the financial statements do not comply with Swiss law and the company’s articles of incorporation...”
Duties of notification (arts. 728c and 729c of the code)	(a) Notification of the board of directors in case of infractions of the law, statutes or the rules of organization (b) Informing the general meeting of shareholders about material infractions of the law and statutes as well as situations when the board of directors does not take appropriate measures after written notification by the audit firm (c) Notifying the judge of an entity’s obvious “over-indebtedness” when the board does not perform the notification	Notifying the judge of an entity’s obvious “over-indebtedness” when the board does not perform the notification
Independence (arts. 728 and 729 of the code)	(a) Comprehensive independence requirements (b) Rotation of the lead auditor (but not the firm) after seven years	(a) Reduced independence requirements (b) Permissible to provide accounting support (c) No rotation requirement

26. Within the legal framework, shareholders dispose of certain options with regard to the audit, if any, to be performed, as shown below.

Figure 1. Audit options



(1) “Opting up”: A group of shareholders representing at least 10 per cent of the share capital may request that an ordinary audit be carried out.

- (2) “Opting out”: Entities that employ less than 10 full-time employees on average may, with the consent of all shareholders, forgo an audit.
- (3) “Opting in”: Companies that are not required to provide an audit report may subject themselves voluntarily to a limited statutory examination.

D. Auditing standards, guidelines and education

27. The Swiss Institute of Certified Accountants and Tax Consultants (SICATC), member of the International Federation of Accountants (IFAC), is the professional association of the public accountants and tax experts. Its standard-setting body works to ensure a high-quality auditing practice in Switzerland.

28. As already mentioned, Swiss law provides only limited accounting guidance based on generally accepted accounting principles (art. 662a of the Code of Obligations). Therefore, SICATC publishes the Swiss Auditing Handbook, which ensures a common understanding among preparers and auditors regarding the application of the legal requirements. The 1998 edition consists of the following four volumes:

- (a) Volume 1: Accounting records and financial reporting
- (b) Volume 2: Audit, reporting by the auditor and internal audit
- (c) Volume 3: Audit in the financial industry
- (d) Volume 4: Other examinations, audits in special industries, public administration and professional aspects

29. Although not legally binding, the handbook’s guidelines find wide acceptance among accounting, legal and auditing professionals. Due to the recent significant changes in the Code of Obligations and the Auditors (Admission and Oversight) Act, the handbook is currently under revision.

30. SICATC also publishes the Swiss Auditing Standards, which represent an adoption of international standards on auditing (ISAs). The current 2004 edition is based on ISAs as published on 30 June 2003. In addition, specific standards have been introduced to provide guidance on Swiss-specific topics, such as audit procedures and internal control systems. These standards must be followed by licensed audit experts when performing an ordinary audit.

31. In order to perform a limited statutory examination, licensed auditors must comply with the procedures found in the relevant specific standard.⁴

32. In 1999, SICATC founded a business school, Educaris AG, which offers preparation for the Swiss-certified accountant exams.⁵ The exams for obtaining this diploma fall under the supervision of the Federal Office of Professional Education and Technology. The exams are currently composed of two main parts. In the first part, five written exams have to be taken in the subjects of financial accounting, management accounting and controlling, corporate finance, tax and auditing. The importance of IFRS as a lecture subject has increased significantly in recent years. In fact, training related to the application of IFRS represents the most significant part of the financial accounting module. In the second part, after passing these theoretical exams and obtaining three full years of on-the-job training, the candidate may apply for the diploma exam. This demanding day-long exam consists of a

⁴ <http://www.treuhand-kammer.ch/pix/files/Standard%20zur%20Eingeschränkten%20Revision%20-%20final%20-%20Dez.%20071.pdf> (in German only, as of 6 June 2008).

⁵ For more information on this topic refer to http://www.academies.ch/standard.cfm?ID_n=26&unter2=26&unter=25&haupt=2&language=1 (as of 20 June 2008).

written case study, oral exams on professional judgment and a short oral presentation on a current accounting topic.

33. After obtaining the diploma, SICATC requests that its members participate in auditing-related events and courses as part of their continuing professional education. Members must log an average 60 hours of continuing professional education annually in order to retain their qualification as a Swiss-certified accountant.

Responsibility of the auditors

34. All persons involved in audits of separate and consolidated financial statements are held responsible for any harm to the entity and its shareholders through deliberate or negligent infraction of their duties (art. 755 of the Code of Obligations). This includes failure to comply with the relevant auditing standards, which are not required by law, but generally taken into account by courts.

35. One of the most serious liability threats is the unique obligation of auditors to declare an audit client bankrupt if the client is “obviously over-indebted”. Over-indebtedness is defined by article 725, paragraph 2, of the code as the total loss of the shareholders’ equity, i.e. where liabilities exceed assets. “Obvious” means that the auditors have to notify the judge “only when the over-indebtedness is much clearer, much bigger, and when it can not be denied even if one looks at the company in an optimistic way”. If this duty is not observed properly, the auditor may be sued under article 755 of the code.

36. The Federal Audit Oversight Authority may also impose monetary fines of up to 100,000 Swiss Francs (SwF) for other infractions (art. 39 of the Auditors (Admission and Oversight) Act), such as violation of independence rules. Tort fines may amount to as much as SwF 1 million for violation of the documentation obligation, the obligation to retain records or refusal to provide information or access to the audit firm (art. 40 of the Act). Further sanctions provide for licence revocation by means of a professional ban on the senior auditor or audit firm in the case of a gross legal violation (art. 17 of Act).

IV. International financial reporting standards in Switzerland

A. Moving towards a true and fair view

37. With the exception of banks, consolidated financial statements have long been prepared in accordance with IAS/IFRS on a more or less voluntary basis. The Code of Obligations has only required consolidated statutory financial statements since 1 July 1994. Furthermore, there did not used to be a federal stock exchange law, and the cantonal stock exchanges in Zurich, Basel, Berne and Geneva did not require consolidated financial statements until 1996.

38. The practice of consolidation, however, began decades ago with large multinational companies that needed to obtain finance to fund mergers and acquisitions on domestic and international stock exchanges. There was a rapid increase in listings on Swiss stock exchanges and some companies sought listings in foreign markets. Although not required by the Code of Obligations or stock exchange regulations, consolidated information was demanded by market forces. Bankers, accounting professionals, auditors, financial analysts, business journalists and others put pressure on public companies to publish more meaningful information than that required by law. Most Swiss companies initially adopted the requirements of the Fourth (78/660/EEC) and Seventh (83/349/EEC) European Community (EC) Directives pending the European single market, thereby enhancing internationality and credibility.

39. In 1984, the Foundation for Accounting and Reporting Recommendations was set up by SICATC to improve financial reporting standards, in particular for consolidated financial statements, because the Code of Obligations limits itself to very basic principles. The general recommendation is that the consolidated financial statements have to provide a true and fair view of the group's financial position, its results of operations and cash flows. The resulting Swiss generally accepted accounting principles (GAAP) and recommendations relative to the presentation of accounts (FER) promulgated by the Foundation at that time followed internationally accepted accounting standards such as IAS (the predecessor of IFRS) and the Fourth and Seventh EC Directives.

40. When Switzerland voted against joining the European Economic Area in 1992, many public companies started to move away from the EC Directives and, depending on financing needs, adopted IAS, Swiss GAAP FER or GAAP of the United States of America as the basis for their consolidated accounts. The profile of IAS was growing rapidly; therefore, many companies opted to report in accordance with those standards.

41. In 1995, listing requirements demanded for the first time that financial reports of all listed companies give a true and fair view of company accounts. In material respects, the requirements were the same as Swiss GAAP FER. In the same year, listing requirements referred to international standards for the first time. Financial statements in compliance with IAS or United States GAAP were accepted for companies listed on Swiss stock exchanges, even if they did not comply with Swiss GAAP FER.

42. In 1998, a study⁶ of a sample of 133 Swiss-listed companies showed the positive influence of size, internationality, listing status, auditor type and ownership diffusion on voluntary compliance with IAS.

43. Since 2005, the SWX Swiss Exchange requires entities listed in the main segment to apply either IFRS or United States GAAP in their consolidated financial statements. Entities listed in the local caps, real estate and investment companies segments may still apply Swiss GAAP FER instead.

B. Regulatory framework

1. Banking and insurance industry

44. The banking and insurance industry is subject to extensive accounting, reporting and auditing regulations. Although banks have to comply with the accounting rules from corporate law (arts. 662–670 of the Code of Obligations), they are governed primarily by the provisions of article 6 of the Banking Act and the related articles 23–28 of the implementing ordinance. In order to specify these requirements, the Swiss Federal Banking Commission (SFBC) set up a framework of Swiss federal bank accounting and financial reporting regulations (RRV-SFBC). This framework was derived mainly from Swiss GAAP FER. In general, the requirements of Swiss banking law are much more comprehensive and specific than those of the Code of Obligations.

45. Banks and their auditors have to report to SFBC, which is responsible for enforcing banking law (the dual supervisory system). These reports are comprehensive and confidential, and therefore not published.⁷ Banks with global operations like UBS and Credit Suisse make use of international financial reporting

⁶ Dumontier P and Raffournier B. Why Firms Comply Voluntarily with IAS: an Empirical Analysis with Swiss Data. *Journal of International Financial Management and Accounting*. 1998. 9: 3.

⁷ More detailed information may be found in the SFBC Guidelines on Accounting Regulations (RRV-SFBC).

standards (IFRS and US GAAP). When applying these standards instead of RRV-SFBC, a bank must disclose any significant differences. Insurance companies are also subject to strict supervision by the Swiss Private Insurance Agency.

46. Banks and insurance companies that neglect their duty to file audited financial statements with the supervisory authorities may have their operating licence withdrawn. In the near future, SFBC and the Swiss Private Insurance Agency will be integrated into the recently formed Financial Market Oversight Agency.

2. Stock Exchanges and Securities Trading Act and requirements for maintaining listing on the SWX Swiss Exchange

47. The Stock Exchanges and Securities Trading Act of 1995 and the associated ordinances are based on the principle of self-regulation. Within this framework, the Swiss stock exchanges (e.g. SWX Swiss Exchange, BX Berne Exchange) are responsible for issuing rules and regulations on the admission of securities for trading, as well as all implementing provisions (art. 8 of the Act). In this respect, internationally accepted standards are to be taken into account. The listing rules and regulations of the stock exchanges govern the admission of securities to trading (secondary market), but not the issuing and marketing of new securities (primary market). Any aspects concerning Stock Exchanges and Securities Trading Act primary market are covered in articles 652a, 752 and 1156 of the Code of Obligations.

48. Some of the key requirements issued by the SWX Swiss Exchange (the main Swiss stock exchange comprising the former cantonal stock exchanges of Basel, Geneva and Zurich) are discussed further below.

49. According to the SWX Swiss Exchange, periodic reporting in compliance with applicable financial reporting and auditing provisions forms an integral part of the information that contributes to a properly functioning market in accordance with the provisions of the Stock Exchanges and Securities Trading Act and the listing rules. One of the tasks of SWX Swiss Exchange is to enforce the applicable transparency provisions.

50. Since 1995, the listing rules of the SWX Swiss Exchange require the presentation of a true and fair view of the issuer's assets and liabilities, financial position and profits and losses (art. 66 of the rules).⁸ If the issuer publishes consolidated financial statements, then the requirement to provide a true and fair view applies only to the consolidated financial statements. The directive on requirements for financial reporting lays down the accounting and auditing standards that are accepted by the SWX Swiss Exchange. Issuers of equity securities that are listed in the main segment must apply either IFRS or United States GAAP as their accounting standard. Companies listed in the local caps, the investment companies or the real estate segments may apply Swiss GAAP FER instead. Foreign companies may adopt their home country's accounting framework if it incorporates the presentation of a true and fair view (as per art. 66 of the listing rules) and provided that the framework has been formally recognized by the admission board of the SWX Swiss Exchange.

51. Financial reporting standards must be applied without exception (IFRS as issued by the International Accounting Standards Board, Swiss GAAP FER as issued by the Foundation for Accounting and Reporting Recommendations and United States GAAP as issued by the Financial Accounting Standards Board).⁹

⁸ http://www.swx.com/admission/regulation_en.html (as of 6 June 2008).

⁹ Directive on requirements for financial reporting,

52. There are additional requirements set up by the SWX Swiss Exchange concerning auditing standards that have to be followed when issuers' financial statements are audited. ISAs are applicable to financial statements prepared in accordance with IFRS, Swiss Auditing Standards to financial statements drawn up in accordance with Swiss GAAP FER, and auditing standards generally accepted in the United States to financial reports prepared in accordance with United States GAAP.

C. Application of IFRS in Switzerland

53. The main source for information about the application of IFRS in Switzerland is provided by the SWX Swiss Exchange, given that almost no information is available about non-public companies, since they are not required by law to publish their financial statements.

Listed companies on the SWX Swiss Exchange

54. Financial reporting standards applied by companies with equity securities primarily listed on the SWX Swiss Exchange for the years 2001–2007 are given below.¹⁰

Table 2. Annual reports and the standards applied

Annual reports/standard	2007	2006	2005	2004	2003	2002	2001
IFRS	191	186	185	145	145	162	155
United States GAAP	17	20	18	19	17	15	14
Swiss GAAP FER	32	34	39	80	87	96	101
RRV-SFBC	20	20	20	21	20	20	20
Home country standards	2	1	1	1	2	2	8
Total	262	261	263	266	271	295	298

Note: The table shows that IFRS represents the predominant financial reporting standard applied by issuers listed on the SWX Swiss Exchange. Between 2004 and 2005, some 40 entities changed their financial reporting standards from Swiss GAAP FER to IFRS in order to satisfy the more rigid requirements for listing on the main segment.

D. Non-public companies

55. There is little information about the application of IFRS for Swiss entities that have not listed their equity and/or debt securities. It is likely that a majority of preparers use Swiss GAAP FER for consolidation purposes. Fewer are assumed to apply IFRS; these encompass entities that are likely to go public in the near future or medium to large entities with an international set-up. Otherwise, it is probable that IFRS for small and medium-sized enterprises will not play an important role in Switzerland, as there may be more costs than benefits bearing in mind that Swiss GAAP FER provides an adequate framework for those entities.

E. Application guidance

56. No formal local interpretations of IFRS are issued in Switzerland.

57. With its published sanction decisions and media releases, the SWX Swiss Exchange is likely to have an influence on issuers applying IFRS. The focus of such sanctions is on full compliance with IFRS, rather than interpreting IFRS.

http://www.swx.com/download/admission/regulation/guidelines/swx_guideline_20070101-2_en.pdf (as of 6 June 2008).

¹⁰ http://www.swx.com/download/admission/being_public/financial_reporting/rle_introduction_en.pdf (as of 6 June 2008).

58. SICATC disposes of an accounting working party that deals with questions related to IFRS, Swiss GAAP FER and the Code of Obligations. The debates take the Swiss legal environment into account when discussing international accounting standards and their application in practice. Significant findings and views may be published in the form of an article in the SICATC accounting journal.

59. In addition, SICATC organizes seminars on practical application of IFRS for auditors and preparers throughout Switzerland.

V. Enforcement of international financial reporting standards in Switzerland

60. In Switzerland, there are various oversight authorities that monitor the quality of financial reporting and auditing. SFBC and the Swiss Private Insurance Agency (and, in the future, the Financial Market Oversight Agency) are in charge of monitoring financial institutions (banks and insurance companies) by law, whereas the SWX Swiss Exchange monitors the financial reporting of issuers other than financial institutions. Auditing requirements are being supervised by the Federal Audit Oversight Authority.

A. Enforcement of international financial reporting standards by the SWX Swiss Exchange

61. Given the vast importance of IFRS applied by issuers, most of SWX Swiss Exchange's enforcement activities in the area of financial reporting relates to this set of standards.

62. It is not the task of the SWX Swiss Exchange to formulate and publish interpretations of specific accounting standards. SWX Swiss Exchange monitors whether the issuers comply with these standards. For this purpose, the regulator applies a risk-based selection of issuers based on criteria such as recent restructurings, business combinations and changes in management, operations, business activities or audit firm.¹¹ Subsequently, a risk-based review of selected financial reports is performed. This review focuses on information relating to standards that have been defined as areas of focus, critical standards on the basis of the company-specific circumstances, standards that are particularly prone to errors and those that are applicable for the first time.

63. Areas of focus set by the SWX Swiss Exchange with respect to IFRS financial statements for 2007 were as follows.¹²

Table 3. Areas of focus set by the SWX Swiss Exchange

Financial instruments: disclosures (IFRS 7)	Completeness of disclosures on the nature and extent of risks arising from financial instruments, as well as for the evaluation of objectives, policies and processes for managing capital as per IAS 1p124A ff. With regard to the quantitative disclosures of the risk exposure required under IFRS 7p34(a), the SWX Swiss Exchange reserves the right to request the relevant documentation that was provided to the board of directors and/or management committee. ./...
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¹¹ http://www.swx.com/download/admission/being_public/financial_reporting/rle_introduction_en.pdf (as of 6 June 2008).

¹² http://www.swx.com/download/admission/regulation/notices/2007/notice_200708_en.pdf (as of 6 June 2008).

Accounting policies (IAS 1)	Comprehensibility and relevance of disclosed accounting policies, as well as their adaptation to concrete, company specific circumstances. The SWX Swiss Exchange focuses on a meaningful, sufficiently detailed disclosure of the accounting policies applied in recognizing revenue (IAS 18).
Income taxes (IAS 12)	Comprehensibility of the reconciliation of anticipated and actual tax expenses or tax rates. In this context, the SWX Swiss Exchange pays close attention to the proper disclosure of unused tax losses as well as the application of the provisions of IAS 12p34 ff. in their recognition.
Related party disclosures (IAS 24)	Completeness and transparency of disclosures required under IAS 24p12 ff. (in particular, compensation paid to members of management, information on related party transactions, as well as on any outstanding balances from such transactions). The SWX Swiss Exchange stresses the importance of quantitative and qualitative aspects in the disclosure.
Intangible assets from business combinations (IAS 38/IFRS 3)	Identification and valuation of intangible assets (e.g. brands, customer lists, recipes) in the purchase price allocation associated with business combinations. A meaningful and factual description of the factors under IFRS 3p67(h) that contributed to the recognition of goodwill. The SWX Swiss Exchange reserves the explicit right to request detailed valuation documentation from business combinations.

64. The Admission Division and the Sanction Commission of the SWX Swiss Exchange may impose sanctions against issuers and auditing bodies for violation of the listing rules, especially in cases of non-compliance with financial reporting requirements.

65. Ongoing investigations in the area of financial reporting are not disclosed, whereas concluded agreements and sanctions are generally published in press releases which include the name of the entity. Most press releases relate to issues concerning financial statements drawn up in accordance with IFRS. In addition, the SWX Swiss Exchange may submit comment letters to issuers where potential for improvement has been identified, while there are no material infractions of financial reporting requirements. These letters are not disclosed to the public.

66. The SWX Swiss Exchange also presents full-text decisions on its website. They are published on a no-name basis in connection with agreements concluded and sanctions pronounced against issuers in the area of financial reporting.¹³

¹³ http://www.swx.com/admission/being_public/sanctions/integrated_publication/financial_reporting_en.html (as of 6 June 2008).

Table 4. No-name decisions (excerpt)

Decisions regarding financial reporting			
The Sanction Commission of the SWX has been publishing its decisions without revealing any names since 1 January 2007. The Admission Division publishes sanctions notifications against issuers and auditing bodies that were reached after 1 January 2007 and have become legally effective. Wherever possible, the full text is published. Before 1 January 2007, sanctions have been imposed by the Disciplinary Commission or the Executive Committee of the Admission Board. Sanctions are only published in their original language (i.e. German, French or English). No translations are produced.			
Decisions regarding Financial Reporting	Proposition of quotation	Body	Download
12.11.2007: Inkorrekte Behandlung von zum Verkauf bestimmten Entwicklungsliegenschaften als Sachanlagen nach IAS 16 anstelle von Vorräten gemäss IAS 2.	GBZ/RLE/VII/07	AD	
12.03.2007: Présentation incorrecte d'une autre unité d'exploitation vendue dans le table des flux de trésorerie consolidés ainsi que publication incomplète des informations à fournir y relative selon IAS 7.	SK/RLE/II/07	SC	
28.02.2007: Nicht vorgenommene Bilanzierung einer Put-Option sowie inkorrekte Bewertung einer Beteiligung nach IAS 39	SK/RLE/I/07	SC	

67. Some erroneous applications of IFRS between the end of 2002 and the end of 2007 that led to sanctions are shown below.¹⁴

Table 5. Erroneous applications of IFRS

IFRS	Title	Number of occurrences
IAS 7	Statement of cash flows	5
IAS 34	Interim financial reporting	5
IAS 39	Financial instruments: recognition and measurement	4
IAS 14	Segment reporting	3
IAS 36	Impairment of assets	3
IAS 11	Construction contracts	2
IAS 24	Related party disclosures	2
IFRS 1	First-time adoption of IFRS	1
IFRS 3	Business combinations	1
IAS 1	Presentation of financial statements	1
IAS 8	Accounting policies, changes in accounting estimates and errors	1
IAS 12	Income taxes	1
IAS 16	Property, plant and equipment	1
IAS 32	Financial instruments: presentation	1
IAS 35	Discontinuing operations	1
IAS 37	Provisions, contingent liabilities and contingent assets	1
Total number of occurrences:		33

¹⁴ http://www.swx.com/admission/being_public/sanctions/integrated_publication/financial_reporting_en.html (as of 6 June 2008).

68. The SWX Swiss Exchange also publishes the Admission Board Circular No. 6 on an annual basis.¹⁵ This circular spells out the obligations of issuers that have chosen to apply IFRS and makes reference to the application of standards that has led to SWX Swiss Exchange complaints. The standards covered by this circular, including further explanations, are shown below.

Table 6. Standards covered by Admission Board Circular No. 6

Materiality, understandability, relevance, completeness (IFRS Framework)
Presentation of financial statements (IAS 1)
Cash flow statement (IAS 7)
Accounting policies, changes in accounting estimates and errors (IAS 8)
Income taxes (IAS 12)
Employee benefits (IAS 19)
Related party disclosures (IAS 24)
Financial instruments: presentation (IAS 32)
Earnings per share (IAS 33)
Interim financial reporting (IAS 34)
Impairment of assets (IAS 36)
Provisions (IAS 37)
Intangible assets (IAS 38)
Financial instruments: recognition and measurement (IAS 39)
First-time adoption of IFRS (IFRS 1)
Share-based payment (IFRS 2)
Business combinations (IFRS 3)
Non-current assets held for sale and discontinued operations (IFRS 5)
Financial instruments: disclosures (IFRS 7)

B. Enforcement of audit requirements by the Federal Audit Oversight Authority

69. The Federal Audit Oversight Authority, which began operating in late 2007, subjects audit firms under State oversight to a thorough inspection (art. 16 of the Auditors (Admission and Oversight) Act). At least every three years, it investigates whether auditing bodies under State oversight have complied with the procedures set out in the auditing standards regarding quality and documentation when providing auditing services to public companies.

70. The Federal Audit Oversight Authority defines the auditing standards that must be applied by audit firms under State oversight when providing auditing services to public companies. If there are no or insufficient standards, the authority

¹⁵ http://www.swx.com/download/admission/regulation/circulars/abcircular_006_en.pdf (as of 6 June 2008).

may issue its own standards or amend and rescind existing standards (art. 28 of the Act). The authority publishes a list of admitted auditing standards (art. 6 of the Ordinance on the Supervision of Audit Firms), which is based on the circular relating the recognition of auditing standards.

71. Separate and consolidated financial statements that are drawn up according to the standards of the Code of Obligations or Swiss GAAP FER must be audited in accordance with the applicable Swiss Auditing Standards (art. 2 of the Ordinance on the Supervision of Audit Firms and the circular relating the recognition of auditing standards). Separate and consolidated financial statements that are drawn up according to foreign accounting standards other than United States GAAP must be audited in accordance with ISAs issued by the International Auditing and Assurance Standards Board, as adopted by the Federal Audit Oversight Authority (framework, ISAs and international standards on review engagements). Furthermore, the audit of separate and consolidated financial statements drawn up in accordance with United States GAAP must be audited according to the United States generally accepted auditing standards of the American Institute of Certified Public Accountants and the Public Company Accounting Oversight Board. Audit-entity-related measures for quality assurance must comply with these standard's quality requirements (e.g. Swiss Auditing Standard PS 220, International Standard on Quality Control 1), depending on the auditing standards applied. The Federal Audit Oversight Authority supervises the quality of auditing services and compliance with auditing standards, notably based on the audit firm's working papers (art. 12 of the Ordinance on the Supervision of Audit Firms) and the quality assurance system implemented. To date, the Federal Audit Oversight Authority has not introduced its own standards, made amendments or rescinded existing standards.

72. The SWX Swiss Exchange and the Federal Audit Oversight Authority are required by law to coordinate their oversight activities to avoid duplication (art. 23 of the Auditors (Admission and Oversight) Act). They inform each other about pending proceedings and potentially relevant decisions.

VI. Summary and outlook

A. Summary

73. The regulatory framework regarding financial reporting, which is laid down in the Code of Obligations, is focused on the protection of creditors. For separate financial statements, there are no exemptions from applying the code, as it represents the basis for taxation, profit distribution and the determination of an entity's over-indebtedness. An exemption from legal requirements is available to entities applying IFRS or any other acceptable foreign standard in their consolidated financial statements.

74. The international exposure and a need to raise external capital drove Swiss entities increasingly towards international standards, the application of which results in a true and fair view. There is limited information available on the adoption of IFRS in Switzerland by entities other than those listed on the SWX Swiss Exchange or any other exchange. IFRS are likely to be used by internationally oriented entities, whereas Swiss GAAP FER, originally developed on the conceptual basis of IAS and the Fourth and Seventh EC Directives, is likely to be used by locally focused entities, including small and medium-sized enterprises.

75. Domestic companies listed in the main segment of the SWX Swiss Exchange are required to apply either IFRS or United States GAAP in their consolidated financial statements (or in their individual financial statements if consolidation is

not applicable). Domestic companies listed in the local caps, investment companies or real estate segments of the SWX Swiss Exchange may alternatively apply the Swiss accounting standard, Swiss GAAP FER. Foreign entities listed on the SWX Swiss Exchange may use their home country GAAP provided that it has been formally accepted by the SWX Swiss Exchange.

76. Enforcement of IFRS comes through the SWX Swiss Exchange as well as audit-related requirements, including the supervision of auditing firms under State oversight by the Federal Audit Oversight Authority, which monitors quality assurance and audit documentation.

B. Outlook

77. A major revision of company and accounting legislation began in 2005 when the Federal Council opened committee hearings. So far the revision has resulted in an opinion issued by the Federal Council regarding these topics¹⁶ and a related draft of the amendments to the Code of Obligations.¹⁷ The aim is to comprehensively modernize company law to align it with the needs of the economy. Corporate governance, in particular, is to be improved. In addition, there will be new rules on capital structures, provisions governing annual general meetings will be updated and new accounting and reporting requirements will be introduced.

78. A draft of the new accounting and reporting requirements (arts. 957–963b of the draft code of obligations) provides for a uniform concept that applies to all legal forms of enterprises of the Swiss civil law. Such new requirements are based on the economic importance of the enterprise and are expected to replace existing requirements that are based on the legal structure of an enterprise (arts. 662 ss. of the code). The requirements relating to the maintenance of accounting records and financial reporting will continue to depend on the requirement for entry in the commercial register.

79. It is expected that small and medium-sized enterprises will be required to prepare financial statements that are comprehensive and clearly structured, consisting of a balance sheet, income statement and notes (arts. 958 ff. of the draft code). There will be no obligation to compile a management discussion and analysis (commonly referred to as an annual descriptive report) or a cash flow statement. Additional requirements will apply to large-scale enterprises. The threshold criteria for those enterprises will be the same as those for the requirement of an ordinary (full-scope) audit: large-scale enterprises are those that exceed two of the three following criteria in two consecutive financial years: total assets of SwF 10 million, revenues of SwF 20 million and a yearly average of 50 full-time employees (art. 727 of the code). As a result, some 10,000 enterprises recognized by the commercial register (out of approximately 484,000 enterprises) are expected to be subject to more stringent rules, which will include preparation of a cash flow statement, additional disclosures in the notes and a management discussion and analysis.

80. According to the draft proposals, public companies, large-scale cooperatives, large foundations and entities subject to a consolidation requirement will have to draw up their (consolidated) financial statements in accordance with a recognized financial accounting framework (e.g. Swiss GAAP FER, IFRS or United States GAAP) that provides for a fair presentation. For all other enterprises, hidden reserves established on a systematic basis will continue to be allowed for tax planning purposes and/or based on an extended application of the prudence principle.

¹⁶ <http://www.admin.ch/ch/d/ff/2008/1589.pdf> (in German only, as of 6 June 2008).

¹⁷ <http://www.admin.ch/ch/d/ff/2008/1751.pdf> (in German only, as of 6 June 2008).

81. For tax purposes, only separate, statutory financial statements prepared in accordance with the Code of Obligations will prevail. However, the revised code will give an enterprise the option to prepare its separate statutory financial statements on a fair presentation basis only. Shareholders representing at least 10 per cent of nominal capital will have the right to require such financial statements on a fair presentation basis, which will enhance transparency and protection of minority shareholders. Separate financial statements drawn up in accordance with a recognized standard will not be required if consolidated financial statements are prepared.

82. Requirements related to the preparation of consolidated financial statements are also being amended. Small groups are exempted from preparing consolidated financial statements if, together with their controlled subsidiaries, two of the three criteria – total assets of SwF 10 million, revenues of SwF 20 million, a yearly average of 50 full-time employees – are not exceeded in two consecutive years, or if they are controlled by entities whose consolidated financial statements are prepared in accordance with Swiss or equivalent foreign requirements and are subject to an ordinary audit. Consolidated financial statements must be prepared, however, if required for a reliable assessment of the entity's financial position and income situation, or if one shareholder, 20 per cent of members of an association or the Foundation Oversight Authority requires it. Consolidated financial statements will have to be drawn up as required in accordance with a recognized financial reporting framework that results in a fair presentation. The Federal Council will have the authority to define the recognized financial reporting frameworks (most likely IFRS, United States GAAP and Swiss GAAP FER).
