PwC International Business Reorganisations Network – Monthly Legal Update

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Welcome

Welcome to the fourth edition of the PwC International Business Reorganisations (**IBR**) Network Monthly Legal Update for 2016.

The PwC IBR Network provides legal services to assist multinational organisations with their cross-border reorganisations. We focus on post-deal integration, pre-transaction separation and carve outs, single entity projects, and legal entity rationalisation and simplification as well as general business and corporate and commercial structuring.

Each month our global legal network brings you insights and updates on key legal issues and developments relevant to multinational organisations.

We hope that you will find this publication helpful, and we look forward to hearing from you.

In this issue

In our April 2016 issue:

- PricewaterhouseCoopers AG (Switzerland) provides an update on the status of revisions to the corporate law provisions of the Swiss Code of Obligation;
- Réti, Antall & Partners Law Firm PricewaterhouseCoopers Legal (Hungary) considers local law requirements to prepare financial statements in accordance with International Financial Reporting Standards and related liability issues; and
- TLS Associazione Professionale di Avvocati e Commercialisti (Italy) reports on Legislative Decree no. 139/2015 and its impact on the preparation of financial statements.

Contact us

For your global contact and more information on PwC's IBR services, please contact:

Richard Edmundson
Partner and Head of International Business Reorganisations, London
+44 (0) 20 7212 1512
richard.j.edmundson@pwclegal.co.uk

PricewaterhouseCoopers AG (Switzerland) – Corporate law under revision

At a glance

The corporate law provisions in the Swiss Code of Obligation (**CO**) are currently under revision. After a first attempt was deferred by other legislative projects, the Federal Council now revived the revision of the corporate law.

This article will briefly describe the status of this major legislative project and shed some light on key issues of the draft legislation, namely:

a introducing flexibility in capital structure;

b reduction of disclosure obligations;

c strengthening minority shareholders;

d diverging dividends;

e gender equality; and

f executive compensation.

In detail

New attempt for corporate law revision in Switzerland

In 2007, the Swiss Federal Council initiated a far-reaching revision of the Swiss corporate law. The revision was aimed at strengthening the rights of shareholders in Swiss companies, introducing flexibility in the capital structure, modernising the rules regarding shareholders' meetings and amending the accounting legislation.

Almost 10 years after the initial motion, the Federal Council now mandated the Federal Department of Justice to elaborate a legislative proposal on the revision of the corporate law. This article intends to briefly describe the events of the last decade and to provide an overview on the main legislative changes that will be covered by the revision.

1. What happened so far

Shortly after the revision of the corporate law was initiated by the Federal Council in 2007, a popular initiative was submitted with the goal to prohibit excessive compensation for board members (**Minder Initiative**). As a result, the Federal Council decided to separate the revision of the accounting legislation, which entered into force in January 2013, and postponed the remaining parts of the revision. In March 2013, the Swiss people endorsed the Minder Initiative, resulting in an immediate amendment of the Swiss Federal Constitution which sets the fundamentals of executive remuneration in Switzerland. This led to the implementation of the Ordinance against Excessive Compensation with respect to Listed Stock Corporations (**OaEC**), which became effective on 1 January 2014.

With no more pending legislation regarding corporate law issues, the Federal Council revived the revision of corporate law in 2014. After having elaborated a first draft and after consultation with interested parties, the following key issues of the revision have been identified.

2. Key issues of the draft legislation

a Flexible share capital

A Swiss company's share capital is determined as a fixed amount which is disclosed in the articles of association and in the Commercial Register. Every adjustment of the share capital must be covered by a resolution of the shareholders' meeting. At least, the shareholders may authorise the board to increase the share capital in a specific amount during a period of up to two years.

The revision shall provide for more flexibility, allowing the shareholders to authorise the board of directors for a maximum of five years to repeatedly adjust the share capital within a given band (+/- 50% of base capital). Moreover, the company's share capital may be denominated in a foreign currency under certain conditions.

b Reduction of disclosure obligations

If a company acquires or intends to acquire tangible fixed assets from shareholders or related parties at incorporation, its articles of associate must name the nature of the (intended) acquisition in kind, the person providing it and the maximum consideration to be paid pursuant to applicable law. The aim of this requirement is to protect creditors by obliging the founders to disclose special benefits which potentially reduce the company's assets. However, the disclosure obligation led to ambiguity in practice, as there is no clear distinction between ordinary business transactions and intended acquisitions in kind in the sense of art. 628 CO. Therefore, the current draft legislation intends to cancel this article.

c Strengthening minority shareholders

Right from the beginning of the discussions on the revision of corporate law, an enhancement of the principle of "one share one vote" was postulated. Despite the fact that a number of corporate scandals are attributed to shares with privileged voting rights, which lead to a misbalance of invested capital and voting power, the Federal Council decided to keep this instrument for the benefit of family controlled small and middle sized entities.

However, the revision intends to strengthen the rights of minority shareholders, for example by prolonging the convocation period for shareholders' meetings, by providing for electronic discussion forums during the convocation period and by introducing a requirement of separate votes on separable topics for shareholders' resolutions.

d Diverging dividends

Another goal of the revision is to allow companies to set incentives for an increased participation in shareholders' meetings. According to the draft legislation, the articles of association may provide for shareholders who vote (don't vote) at the general meeting to receive an increased (reduced) dividend of up to 20% of the dividend resolved. Whilst an increased participation in shareholders' meetings might undoubtedly be desirable, diverging dividends are particularly controversial with regard to equality of shareholders, the imposition of additional duties on shareholders and increased administrative effort for the companies.

e Gender equality

In 1981, a legislative assignment was introduced to the Swiss Federal Constitution (art. 8) which states that the law shall ensure equality of men and woman, both in law and in practice, especially in the family, in education and at work. The revision of corporate law now intends to implement thresholds for women in the board of directors (30%) and the management (20%). However, companies may deviate from this requirement by stating reasons (comply-or-explain approach). A ten years transition period is envisaged.

f Executive compensation

Finally, it is intended to transfer the provisions on excessive executive pay which are currently set out in the OaEC into the CO. Most importantly, the OaEC prohibits advanced compensation and severance payments, sets increased disclosure requirements (remuneration report) and provides for a binding shareholder vote on executive remuneration. The draft legislation does not provide for material changes compared to the OaEC, which is only in force as of January 2014.

3. Outlook

Ten years after its first launch, the revision of the Swiss corporate law provisions is again at its very beginning. The draft legislation contains some extensive changes to the currently applicable law. Deliberations in the Swiss Parliament are scheduled for 2017 and will show if and to which extent the Swiss corporate law will be revised.

Who to contact

For more information, please contact:

Lukas Bühlmann
Senior Manager, St. Gallen, Switzerland
+41 58 792 72 83
lukas.buehlmann@ch.pwc.com

Réti, Antall & Partners Law Firm PricewaterhouseCoopers Legal (Hungary) – IFRS in Hungary and the related liability issues

At a glance

Due to changes in the Hungarian legislation, companies can choose to prepare their financial statements in accordance with International Financial Reporting Standards (**IFRS**) instead of the provisions of the Hungarian Act on Accounting, already in 2016. From 2017, in certain cases this will be obligatory. But what if a company is not affected by the scope of the mandatory application; what if a company can decide whether to opt in or opt out? Ultimately, it will be the shareholders' meeting that will pass the resolution on the acceptance of the financial statements; however, the draft resolution will be prepared by the management, with the involvement of the supervisory board and the audit committee, if applicable. Thus, there may be liability issues pertaining to the recommendation to transfer or not to IFRS, since such recommendation (or the lack of it) can have as a result various tax, administrative and other burdens. Clear-cut corporate rules governing the process of decision-making and its preparatory phase, and informed decision-making can reduce potential risks on the management's side.

In detail

IFRS-related duties

From 1 January 2017, certain companies (generally, financial institutions and companies whose securities are admitted to trading on an EEA-stock exchange) must prepare their financial statements in accordance with the IFRS-rules. In a number of cases however (e.g. in case of companies where statutory audit is applicable), the company can decide whether it will opt for IFRS. In such a situation, although the financial statements will be adopted by the company's shareholders' meeting, it is the management's duty (except if regulated otherwise at the company) to, for example, prepare the corporate decisions necessary for the transfer to IFRS and the amendments of various internal documents, adopt detailed rules of procedure and, eventually, prepare the financial statements. If there is a supervisory board or audit committee in place at the company, their members are (amongst other things) liable for liaising with the company's auditor, reviewing the financial statements and delivering an opinion on it.

Associated fiduciary duty

Under the Hungarian Civil Code, the management is liable towards the company in accordance with the rules governing the breach of contract. (The same rules apply to supervisory board and audit committee members as well.) These rules provide for an objective liability in the case of which exculpation is very limited. Due to this reason, it becomes important to examine whether the precondition for establishing the liability is fulfilled, namely whether there has actually been a breach of contract.

The duty of the management - just like that of the supervisory board and audit committee members - under the contract is a fiduciary duty, i.e. a duty to perform work with due diligence and care, not an obligation to produce a result (e.g. to hold harmless the company from any and all losses). Accordingly, in order to be able to establish that the contract was breached, it has to be proven that the management had not performed a particular duty with due care and diligence. In order to show this, clear-cut rules specifying the responsibilities are necessary.

How to limit the liability?

How do all of the above relate to the duties of the management with respect to transfer to IFRS?

1. Clarify roles and responsibilities

Even though the financial statements of the company will be adopted by the shareholders' meeting, it may not be self-evident which corporate body or officer is responsible for preparing the decision on such a transfer, what other internal documents will have to be amended/adopted, etc.. These matters should be clearly regulated in the company's foundation document, bylaws and rules of procedure. Such a clear regulation triggers a twofold "limitation" at the same time: the limitation of liability and the limitation of risks. The liability of the management will be limited since there will be no vague provisions, on the basis of which the liability could be established. Simultaneously, the company will limit the risks that might arise from an eventual dispute between its executives, which would be based on provisions that are too vague and the result of which may be at least uncertain.

2. Be aware

A diligent and duly careful performance of the clear-cut duties necessitate that the management, the supervisory board and audit committee members are aware of the risks the company may face upon a given decision. Thus, even in cases in which the ultimate decision does not lie in the hands of the management, they should identify the possible consequences of such a decision, in order to enable informed decision-making.

3. Consult

Under Hungarian law, at least one member of the audit committee must be a person having professional accounting or audit qualification; however, no such requirements apply to the management or the supervisory board. Accordingly, it is possible that those who prepare the decision on the transfer to IFRS may not be the best equipped with necessary professional tools. Their liability may however be limited if they rely on professional advice provided by various service providers having extensive knowledge and skills on IFRS.

Who to contact

For more information, please contact:

Dr. Dóra Horváth
Law Firm Member, Budapest
+36 1 461 9281
dora.horvath@hu.pwclegal.com

Dr. Miklós Klenanc, LL.M.
Attorney-at-Law, Budapest
+36 1 461 9831
miklos.klenanc@hu.pwclegal.com

TLS Associazione Professionale di Avvocati e Commercialisti (Italy) – Legislative Decree No. 139/2015 – A new face for Financial Statements 2016

At a glance

Kick off for the restyling of Financial Statements thanks to Legislative Decree no. 139/2015, entered into force on 1st January 2016.

Following the footsteps of Directive 2013/34/EU of the European Parliament and of the Council, the Italian Decree, in fact, has made many changes to both ordinary and consolidated financial statements.

Not only innovations in reference to accounting principles, financial statement's structure, auditors' powers as well as to identifying size thresholds have been introduced, but also a system based on a more suitable relation between accounting and administrative duties and companies' dimensions has been implemented.

In detail

The Legislative Decree no. 139/2015 (**Decree**) was published in the Official Gazette of the Italian Republic on September 4, 2015 and entered into force on January 1, 2016.

The Decree was approved in implementation of Directive no. 2013/34/EU in order to simplify the administrative and financial fulfilments pending on the companies, especially those smaller in size, as well as to achieve a greater degree of clarity and comparability among the schemes of financial statements in the European Union.

The Decree introduces, *inter alia*, some amendments to the discipline of the financial statements as regulated by the Italian Civil Code. In particular, under a merely legal standpoint, the new legislation intervenes, among others, on the following aspects: general principles applicable to the draft of the financial statements, mandatory documentation required, distinction among companies based on their sizes and auditors of accounts.

1. General principles for the drafting of the financial statement

With reference to the general principles guiding the drafting of the financial statements under the Italian law, these have been broadened by the Decree. In particular:

a a new paragraph 4 was added to Section 2423 of the Italian Civil Code. Such addition provides for a "*principle of materiality*" according to which recognition, measurement, presentation and disclosure in financial statements should be subject to materiality constraints, that is to say they must not be irrelevant in order to provide a true and fair view of the financial conditions of the company. In particular, according to the Directive 2013/34/EU, "*material*" means the "*status of information where its omission or misstatement could reasonably be expected to influence decisions that users adopt on the basis of the financial statements of the undertaking. The materiality of individual items shall be*

assessed in the context of other similar items"; and

b the new legislation also affects the "*substance over form*" principle which has been clarified in the new paragraph 1-*bis* to Section 2423-*bis* of the Italian Civil Code. According to such paragraph, the measurement and the presentation of the items in the financial statements shall be made in such a way to give prominence to the content of the agreement or the transaction rather than to the legal form used to describe the operation.

2. Documentation required by the law for the financial statements

Substantial changes have been made also with respect to the mandatory documentation required by the law for the schemes of financial statements.

In particular, one of the main changes introduced by the Decree concerns the cash flow statement ("*rendiconto finanziario*"). This is now governed by the new section 2423 paragraph 1 of the Italian Civil Code (as integrated by virtue of the Decree) and must be seen as an integral part of the ordinary financial statements, together with the profit & loss account ("*conto economico*"), the balance sheet ("*stato patrimoniale*") and the explanatory note ("*nota integrativa*").

Accordingly, the drafting of the cash flow statement is now mandatory for all those companies required to prepare the ordinary financial statements and it is no longer limited to listed companies, as it was under the previous legislation.

In particular, the cash flow statement shall contain, with reference to the financial year to which the financial statements refer to and to the previous one, the amount and composition of cash, at the beginning and at the end of each financial year, as well as the cash flows during such period originating from operating, investing and financing activities, including the transactions with the shareholders (which shall be indicated separately).

3. Treasury shares

Moreover, the Decree amended Section 2357-*ter*, paragraph 3 of the Italian Civil Code, with respect to the purchase of treasury shares. In particular, prior to the amendment, companies were required to constitute a non-disposable reserve in the financial statements for an amount equal to the value of the own shares so purchased.

Under the new legislation, the purchase of treasury shares determines a reduction of the company's net worth ("*patrimonio netto*") for a corresponding amount, by inserting, with a negative sign, an equivalent item among the liabilities of the financial statements.

4. Distinction among companies based on their sizes

In addition to the above provisions, the Decree also introduces a distinction between micro, small and medium/large companies on the basis of fixed parameters, such as:

a total assets of the balance sheet ("*stato patrimoniale*");

b net revenues from sales and services; and

c average number of employees during the financial year.

In particular, with respect to the micro-enterprises, the new legislation introduced Section 2435-*bis* to the Italian Civil Code, according to which such category of enterprises is exempted from the need to draft the cash flow statement, the explanatory note, and the management report ("*relazione sulla gestione*").

In order to have an overview of the structure of the financial statements on the basis of the size of the relevant companies, please refer to the chart below **(*)**.

5. Auditors of accounts

At last, the Decree provides for wider powers that shall be given to the auditors of accounts. Auditors of accounts are now required to draft a specific report that shall contain:

a not only an opinion on the consistency of the management report ("*relazione sulla gestione*") with the financial statements (as already provided for under the previous legislation), but also an opinion on the compliance of such report with applicable law provisions; and

b a declaration released by the auditor on the basis of the overall knowledge of the company as acquired during the auditing activities, concerning any significant errors in the management report and containing indication of the nature of such errors.

6. Brief overview of the main accounting amendments

The Decree also introduces specific amendments under an accounting standpoint. For the sake of completeness, such amendments mainly concern reporting formats and evaluation criteria of the financial statements, explanatory note and the consolidated financial statements.

Under an accounting prospective, it is important to highlight that, even though, the Decree became effective on January 1, 2016, and, therefore, will only apply to the financial statements for 2016 and following years, the new provisions could also affect the 2015 financial statements according to the general principles of "*continuity* and *comparability*".

Who to contact

For more information, please contact:

Clara Isabel Ceccarelli
Senior Manager, Rome
+39 06 57178553
clara.ceccarelli@it.pwc.com

Alvise Becker
Senior Manager, Milan
+39 02 91605229
alvise.becker@it.pwc.com

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Size-class of the enterprises	Identification Criteria			Financial statement composition
	Total assets of the balance sheet	Net revenues	Average number of employees	
Micro enterprises - 2435-*ter*, *Italian Civil Code*	Up to € 175,000	Up to € 350,000	Up to 5	▪ Balance sheet ▪ Profit and loss account
Small enterprises - 2435-*bis*, *Italian Civil Code*	Up to € 4,400,000	Up to € 8,800,000	Up to 50	▪ Balance sheet ▪ Profit and loss account ▪ Explanatory note
Medium/Large enterprises - 2423 ss., *Italian Civil Code*	Exceeding, for over two consecutive financial years, of at least two of the above thresholds provided for small enterprises.			▪ Balance sheet ▪ Profit and loss account ▪ Explanatory note ▪ Cash flow statement

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