Chapter 1 Legal Basis of Accounting

1,1 Unternehmensgesetzbuch (UGB) – Commercial Code

In Austria the accounting rules are regulated by the Unternehmensgesetzbuch (UGB), the commercial code.

On 23 June 2013 the European Parliament and the Council issued the „Directive 2013/34/EU on annual Financial Statements, consolidated Financial Statements and related reports of certain types of undertakings.

Based on this directive all EU member states had to adjust the local accounting rules to comply with this directive.

Austria adopted the rules beginning with fiscal year 2016.

The sources of Austrian GAAP in addition to the legal rules are:

- Statements of the AFRAC (Austrian Financial Reporting and Auditing Committee)
- Statements of adivisory bodies (Fachsenate) oft he chamber of tax advisors and auditors
- Statements of the institute of auditors (IWP)
- Comments on the commercial code.

Any comments to the EU directive are also sources for interpretations of the Austrian accounting rules.

1,2 Tax Rules – Principle of Congruence

To some extent Austrian Tax Rules influence the practice of accounting. Principally Tax accounting depends on financial accounting. Still there are coherences between those rules. Tax Accounting is determined by financial accounting rules.

This „principle of congruence“ is based on § 124 BAO (this law provides the procedures of taxation) and on § 5 (1) EStG (Law on income taxes).

The profit of financial accounting has to be taken as taxable profit. Only if specific tax rules deviate from the acconting rules, the accounted profit has to be adjusted to receive the taxable profit.

BEISPIEL einfügen

The effect of this principle of congruence is that estimates in financial accounting might be influenced by tax planning decisions.

Chapter 2 General Assumptions

2,1 Obligation to prepare Financial Statements

§ 189 UGB determines who has to prepare financial statements under the rules uf UGB.

Every undertaking has to prepare Financial Statements if the revenues exceed EUR 700.000,00 for two years in a row. The obligation takes place in year 3. Financial Statements have to be prepared beginning with the following year If the revenues exceed EUR 1.000.000,00.

Corporations and partnerships which are treated as if they would be a corporation have to prepare financial statements under the rules of UGB at any amount of revenues, even at zero revenue.

2,2 Objectives of accounting – fundamental norm

The objectives of Austrian GAAP are expressed in the „fundamental norm" (Generalnorm). Austrian UGB provides two different types of fundamental norms. It depends on the type of undertaking which fundamental norm has to be obeyed.

- Non corporations - § 195 UGB

  The financial statements have to comply with general accrpted accounting principles. They have to provide a true and fair view of the assets and liabilities and of income of the undertaking to the undertaker.
- Corporations - § 222 (2) UGB

  The financial statements have to provide a true and fair view of assets and liabilities, income and financial position of the corporation. If this requirement is not fullfillable the management has to explain this in the notes.

2,3 General assessments

2,3,1 Requirements and Procedures

Bookkeeping must be (§ 190 UGB)

- Qualified to give an overview over the business transactions and the position of the undertaking;

- Prepared in a living language;
- Entries must be complete, true, timely and sorted;
- Entries must not be changed. You always have to see the original entry;
- Electronic storage is possible.

Storage period is 7 years.

At every closing date a table of all assets and liabilities is to be prepared (Inventar - § 191 UGB).

All assets have to be counted once a year. Forms of **taking inventory** can be (§ 192 UGB):

- Count at closing date;
- Count before (up to 3 months) or after (up to 2 months) closing date;
- „Permanent count“. If the undertaking uses an electronic system to control stock (every addition an every removal to and from stock is to be accounted for) it is possible to spread stock count over the fiscal year. Every item has to be counted.
- Using a statistical sampling system is also permitted. This is the only method of stock count which allows you not to count the complete stock.

At beginning of the fiscal year an opening balance sheet hast o be prepared. (§ 193 (1) UGB)

The balance sheet at closing date has to be prepared until up to 9 months after closing date. (§ 193 (2) UGB)

The fiscal year must not last longer than 12 months. (§ 193 (2) UGB)

The **financial statements** consist of a balance sheet and a income statement. It must be prepared in EURO and in german language. (§ 193 (4) UGB)

Financial statements have to be signed by the undertaker or by each of the partners with unlimited reliability. (§ 194 UGB) Corporations are represented by the management. Each representative has to sign the financial statements of a corporation.

2,3,2 General accounting principles (GOB)

Principle of completeness (§ 196 (1) UGB)

A set of financial statements (§ 196 (1) UGB) has to consist of all

- Assets,
- Provisions,
- Liabilities,
- Deferred expenses and deferred income,
- Income and expenses.

It is **prohibited to offset** (§ 196 (2) UGB)

- Assets and liabilities and
- Income and expenses.

Example: offsetting of assets and liabilities
Company A recognizes in the books Trade receivable at the amount of 10.000 and a trade payable at the amount of 8.000 against company B. If Company A does not have the legal right to offset these two balances they have to be recognized seperately in assets and liabilities. Only if the two companies agree upon a partial settlement they are allowed to offset those two items.

Principle of consitency (§ 201 (2) Z 1 UGB)

Accounting policies, used in previous financial statements have to be applyed to current financial statements. If a change in accounting policies results in the presentation of a more correct position of the undertaking, it is possible to do so. Corporations have to explain this in the notes. (§ 201 (3) UGB)

Example: consistency
Company A calculates depreciations of manufacturing engines by using the straight line method. Since the value of such machines has a high relation to usage, the unit of production method would show the more precise value of the machines. In this case it is possible to change the accounting method.

Prinicple of Going Concern (§ 201 (2) Z 2 UGB)

The **going concern principle** is the assumption that an entity will remain in business for the foreseeable future. Conversely, this means the entity will not be forced to halt operations and liquidate its assets in the near term.

Example: Going Concern
Company A has to file bankruptcy. The value of fixed assets can be calculated in two ways: Cost minus depreciation: 300.000 Liquidation value: 40.000 In this case going concern is impossible because Company A is not able to stay in business. The correct value of fixed assets is tnhe liquidation value (40.000).

Principle of single valuation (§ 201 (2) Z 3 UGB)

Each single item of a group of assets or liabilities has to be valuated seperately.

Example: single valuation
Company A purchases two different bonds. Purchase price of each bond is 1.000. At closing date the fair value of bond 1 drops to 800 and the fair value of bond 2 increases to 1.200. The total value of both bonds is still 2.000. The impairment of bond 1 is to be recognized. Cost must not be exceeded in valuation of assets. Therefore it is not allowed to increase the bookvalue of bond 2. The total value of both bonds is to be recognized at 1.800.

Principle of prudence (§ 201 (2) Z 4 UGB)

- **Principle of recognition of revenues**
  Revenues may be recognized as soon as one got the title to receive a consideration in exchange for the transferred good or service. This can be when risk or control changes from seller to buyer.
  Under Austrian accounting rules there is no possibility to recognize revenues over time like at percentage of completion. In Austria revenues only are recognizable if the complete transaction is fulfilled (completed contract method).

Example: recognition of revenues
Company A delivers goos to a customer. The incoterm agreed upon is „free Factory Customer B“. The delivery beginns on December 31st Year 1. Customer B receives the goods on January 2nd Year 2. The revenue is to be recognized in January Year 2 because risk of damage of the goods is transferred at January 2nd Year 2.

- **Principle of recognition of losses**
  Identifiable risks and expected losses have to be recognized in the period of causing.
  The probability of loss must be higher than 50%.

Example: recognition of losses
Company A sells goods to Customer B. Customer B claims warranty. The lawyer of Company A expects a payment to Customer B at probability of 75%. Company A has to recognize a warranty provision.

- **Impairment expenses** have to be recognized no matter if there is profit or loss.

Accrual Principle (§ 201 (2) Z 5 UGB)

Under this concept expenses and income have to be accounted for in the period they occur and not in the period related cashflows occur.

Example: accrual of expenses
Company A receives a maintainance service on December 27th Year 1. The settlement of the invoice will occur in year 2. Company A has to recognize these maintainance expenses in Year 1.

Principle of identity of Closing Balance Sheet and Opening Balance Sheet (§ 201 (2) Z 6 UGB)

The opening balance sheet oft he current period hast o be identical tot he closing balance sheet of the prior year. If any item of the balance sheet of the prior year would be changed in the opening balance sheet of the current year there would be a change in equity. It is not allowed to change equity of a prior year´s balance sheet because retained earnings are determined by decision of the owners/shareholders. Retained earnings are the basis for dividends. This is why retained earnings must not be altered after determining them by the shareholders.

Estimates (§ 201 (2) Z 7 UGB)

Estimates have to be assessed under caution. Statistical materials should be taken into consideration if given.

Materiality (§ 189a Z 10 UGB)

Any information has got the status of material, if you leave out the information or you give false informations about it in financial statements, the addressee´s decisions would be influenced. Materiality is always dependend on the size of an item or the importance of an item. If single items are not material, a group of single not material items may be material.

2,3,3 Definitions

Asset

An asset is a resource

- controlled by the entity,
- leads to future benefit,
- is separable,
- results from
  - purchase,
  - production, or
  - contribution of a shareholder.

Separability means that the asset can be transferred to other persons without causing any damage to the asset.

An asset can be **tangible** or **intangible**.

Fair Value (§ 189a Z 3 UGB)

Fair value is the value a buyer of a whole undertaking would allocate to a single item (asset or liability) of the purchased operation as share of the total purchase price. The value must be taken under the perspective of going concern.

Fair Market Value (§ 189a Z 4 UGB)

Fair market value can be a listed marketprice. A fair market value can be calculated using accepted calculation modelst hat are linked to listings of close values If there is no special listing for types of financial instruments.

Acquisition Costs (§ 203 (2) UGB)

Acquisition Costs are expenses to purchase an asset and make it ready to use. Those costs must be directly attributable.

Calculation of acquisition costs:

	Purchase price
plus	ancillary costs
plus	additional costs after purchase date
minus	price reductions (rebates and discounts)
total	**acquisition costs**

Examples for **ancillary costs**:

- shipping costs
- tariffs
- non refundable taxes
- insurance costs
- costs of mounting machines
- costs of testing machines

Training costs have to be expensed.

Cost of Production (§ 203 (3) UGB)

Cost of production are expenses to

- produce an asset,
- to expand (extend, enlarge) an asset, or
- to enhance an asset far over the given condition.

Cost of production must consist of direct cost and indirect cost.

<u>Calculation of cost of production:</u>

	Direct material costs
Plus	direct labour costs
Plus	inderect material costs
Plus	indirect production costs
Total	**cost of production**

Fixed indirect cost are only to be taken under consideration as long as they are calculated from a basis of average use of capacity.

Options to allocate to cost of production:

- costs of social facilities,
- Costs of pensions and severance payments,
- Finance costs if the liability is there to finance the produced item and interest cost are allocated to the period of production (§ 203 (4) UGB)

Costs of general administration and costs of distribution must be expensed.

Example: Cost of production	
The manufacturing of produce 1 takes the following costs per unit:	
Direct material costs:	1.000
Direct labour costs:	2.000
Indirect material costs (based on direct material costs):	10%
Indirect labour costs (based on direct labour)	300%
The production capacity is only used at 70%.	
Distribution costs (based on total production cost):	15%
General administration costs (based on total production cost):	10%
<u>Calculation of cost of production:</u>	
Direct material costs	1.000
Indirect material costs (10% of 1.000)	100
Direct labour costs	2.000
Indirect labour costs (300% of 2.000 * 70%)	1.800
Total cost of production (for 1 unit)	**4.900**

Contributions by shareholders (§ 202 UGB)

Contributions by shareholders have to be recognized at fair value. If the value under going concern is lower than the fair value this value is to be taken.

Example: contributions by shareholders
Partner A transfers a machine showing a fair value of 100.000 to Company A. The machine exceeds the capacity Company A would need. A machine with the needed capacity could be purchased at 70.000. The contribution must be recognized at 70.000.

Chapter 3 Financial Statements

3,1 Non corporations

Non corporations can be

- Sole Proprietorship,
- Partnership (Offene Gesellschaft – OG),
- Limited Partnership (Kommanditgesellschaft – KG).

A limited partnership has got to types of partners:

- Komplementär (partner with unlimited liability)
- Kommanditist (partner with limited liability).

The owner of a sole proprietorship and the partners of a OG have no limitation in liability.

Key parameters of non corporations				
	Sole Proprie torship	**OG Part-nership**	**KG Kom-plemen-tär**	**KG Kom-manditist**
Legal person	NO	NO	NO	NO
Minimum capital contribution	NO	NO	NO	YES
Limited Liability	NO	NO	NO	YES
Owner/Partner = manager	YES	YES	YES	NO

There is no legal minimum capital contribution for Kommanditisten. It depends on the articles of partnership. The limited liability is to transfer the agreed contribution to the partnership.

The financial statements of non corporations consist of

- Balance Sheet and
- Income Statement.

They have to obey the rules of procedures and the valuation rules. There is no obligation to use classification rules like for corporations. It is only recommanded.

The minimum classification of a balance sheet looks as follows (§ 199 UGB):

Balance Sheet	
Assets	**Equity/Liabilities**
A. Non Current Assets	A. Equity
B. Current Assets	B. Provisions
C. Deferred Expenses	C. Liabilities
	D. Deferred Income

The income statement is based on the same rules like the income statement of corporations.

3,2 Corporations

Corporations can be

- the Aktiengesellschaft (AG) – public corporation, inc.
- the Gesellschaft mit beschränkter Haftung (GmbH) – privat limited corporation

There is an additional type of AG in Europe, the SE (Sociatas Europaea). This is an AG which is seated in two European (EU) countries. The rules are almost the same like the rules for Aktiengesellschaften.

Partnerships may be treated as corporations if there is no physical person partner with unlimited liability. The most common example would be a „GmbH & Co KG“

Key parameters of non corporations		
	AG	**GmbH**
Legal person	YES	YES
Minimum capital contribution	YES	YES
	70m€	35m€
Limited Liability	YES	YES
Owner/Partner = manager	NO	NO

The financial statements of corporations consist of

- Balance Sheet
- Income Statement
- Notes

In addition to the financial statements a corporation principally has to prepare a management report (§ 243 UGB).

The accounting obligations for corporations differ according to the size of a corporation.

There are 4 types of corporations from the aspect of size (§ 221 …):

- Micro (only for GmbH)
- Small
- Medium size
- Large size

Two of the three aspects have to be exceeded (for micor size have to come below) for two years to change to the next size.

	micro	small	medium	lagre
Total assets	<350m€	350m-5M€	>5M€	>20M€
revenues	<700m€	700m-10M€	>10M€	>40M€
employees (capita)	<10	10-50	>50	>250

Accounting obligations depending on size:

- Scope of notes
- Obligation to prepare a management report
- Obligation to audit the financial statements
- Scope of disclosure

Scope of notes

Micro corporations do not need to prepare notes. The scope of notes increases by size.

Management report

Micro and small GmbHs do not need to prepare a management report.

Audit

Micro and small GmbHs do not need to get their financial statements audited.

Disclosure

The scope of disclosure differs depending on the size of a corporation.

3,3 Valuation of Assets

3,3,1 Non Current Assets

The business model for the use of non current assets is to use them more than a year, at least over a period longer than the upcoming closing date.

Non current assets consist of

- Intangible assets,
- property, plant and equipment and
- financial assets.

By definition intangibles are assets of no physical substance and no financial assets. Examples for intangibles are

- Legal or contractual rights like
  - Licenses,
  - Brands,
  - Customer relations, etc.
- Goodwill.

Goodwill is not defined to be an asset, even beeing treated as one. The definition and calculation of goodwill will be part of section ….

Main objects of fixed assets are

- Properties, land, buildings,
- Plants and machinery,
- Equipment.

Financial assets consist of

- Investments, participation rights,
- Loans,
- Other financial assets like bonds, etc.

Non current assets are recognized at cost (acquisition cost or production cost).

If it is possible to define a useful life of non current assets, intangilbe assets have to be amortized and tangible assets have to be depreciated. There is no amortization for non current financial assets.

The **most common depreciation methods** are:

- Straight line method,
- Declining balance method,
- Units of production method.

In Austria the straight line method is used most frequently because it is the only method which is accepted for tax purposes.

In the financial year of purchase or disposal there are special rules for calculation of the depreciation. If a purchase takes place within the first six months of a financial year a full year´s depreciation is recognized. Any later purchase would be depreciated at half of a full year´s depreciation.

In case of disposal within the first six months of a year the depreciation will be 50% of a full year´s depreciation. Selling an item after six months a full year´s depreciation is used.

Amortization of **goodwill** is based on it´s useful life or if there is no possibility to define it´s useful life goodwill is amortized over 10 years. (§ 203 (5) UGB)

Low value assets may be depreciated/amortized at once. In Austria the upper limit of purchase price for low value assets is set at 400 EUR per item. If a group of low value assets is to be seen as unit the purchase price of the group of assets must not exceed 400 EUR to qualify as low value asset. (§ 204 (1a) UGB)

If the fair value of non current assets is lower than the book value for an expected period of more than one year, imediate **impairment** is necessary. Those impairment expenses have to be classified seperately in income statement. (§ 204 (2) UGB)

As soon as the fair value exceeds the amortized cost value again apreciation is to be recognized. The upper limit of apreciation is the amortized cost value (cost of purchase or procuction reduced by amortizations/depreciations). If impairment is only temporary it is not accepted to reduce the bookvalue of non current assets. (§ 208 UGB)

Financial assets may be impaired even if a loss of value below cost is not non current. The expectation of long term lower values would cause immediate impairment.

Example: impairment of land
Entity A purchases land for building a sanatorium. The purchase price was 4.000.000. Six months after the purchase (end of year x1=closing date) the authorities turn out with the information that a highway is planned right next to the premises. The fair value of the premises drops to 1.500.000. After protests in year x3 the plans for the highway are cancelled. The fair value of the premises increases to 4.100.000. Year x1: The premises has to be impaired by 2.500.000. It is obligatory to recognize this impairment because of the expectation of permanent loss in value. Impairment expenses have to be classified in income statement seperately. Year x3: An immediate appreciation is obilgatory ss soon as the cause of impairment is gone. The recognized value after appreciation is 4.000.000 again. There is no appreciation over the upper limit of 4.000.000 which represents the purchase price.

Example: impairment of assets with finite useful life
Entity Y started to use a group of machines which have been customized for entity Y. The machines have been recognized at beginning of year x1 at a cost value of 10.000.000. The useful life was estimated to be 10 years. In year 5 sales of the procucts produced with this group of machines decline seriousely. The fair value of this group of machines is estimated to be 2.000.000. In year 6 because of intense marketing activities the sales return to the level two years before. The fair value increases to 4.500.000. <u>Year 1:</u> After depreciation the group of machines is recognized at 9.000.000. <u>Year 5</u>: Because fair value is lower than amortized cost (cost 10.000.000 minus accumulated depreciations of 5.000.000 equals an amortized cost value of 5.000.000) impairment has to be recognized to fair value of 2.000.000. <u>Year 6:</u> The cause for impairment is gone. Appreciation to amortized cost of 4.000.000 is obligatory.

Example: impairment of financial assets
In year 1 financial entity X purchases bonds at cost of 1.000.000. End of year 1 the listed price drops to 980.000. It is estimated that the drop in value is not permanent. At end of year 2 the listed price goes up to 1.050.000. Option 1: There is no need to impair the bonds to 980.000 because the cause of impairment is estimated to be short term. Option 2: <u>Year 1:</u> Even if the cause of impairment is estimated to be only of short period it is possible to recognize impairment. The carrying amount is set to 980.000. <u>Year 2:</u> After the recovery oft he listed price the bonds have to be valuated at cost of 1.000.000. The appreciation is mandatory.

Received **investment grants** from a public organisation have to be recognized as **deferred income**. There is no legal rule behind this method but the commentaries to UGB recommend this. The recognized grant must be transfered to other income over the useful life of the fixed assets which have been government-sponsored.

Investment grants are classified as a seperate item after equity in the balance sheet.

Example: investment grants
In year 1 entity G purchases a production unit at cost of 1.000.000. Because of meeting governmental funding guidelines entity G receives a non repayable grant from the government of 400.000. The useful life of the production unit is estimated to be 20 years. Year 1: Entity G depreciates the Production unit by 50.000. At the same time the government grant has to be transfered to other income by 20.000.

3,3,2 **Current Assets**

The business model for the use of current assets is to use or sell them within the current year.

Current assets consist of

- inventories,
- Receivables or other current assets,
- Current financial assets and
- Cash and cash equivalents.

§ 206 (1) UGB provides the provisions for the valuation of current assets.

Current assets have to be recognized **at purchase cost or production cost**.

§ 207 UGB states that If the fair market value is below cost, immediate impairment is mandatory. If there is no listed price fair value has to be calculated and compared with cost.

Any current asset has to be valuated „loss free“. When using or selling a current asset the return minus point of sales cost must cover cost. Otherwise there is a need for impairment. This value to compare cost with is called the „**Net Realizable Value**“.

Calculation of net realizable value:

Expected selling price

- Upcoming cost of sales

= **Net realizable value for purchased goods and finished goods (products)**

- Upcoming cost of production

= **Net realizable value for unfinished goods (work in progress)**

Expected selling price

- fixed price out of an pending engagement
- expected price deducted from the price list minus rebates and discounts

Cost of sales

- costs of shipment
- costs of commissions
- etc.

Cost of production

- Costs to finish the product.

Profit margins, administration costs and fixed distribution costs are not taken into consideration in this calculation.

Example: net realizable value
Entity A calculates production costs for Products A and B: Product A: 500 (finished product), 350 (unfinished product) Product B: 600 (finished product), 500 (unfinished product) Expected selling price: Product A: 700 Product B: 650 Profit margin: Product A: 20% Product B: 25% Cost of sales: