External Reporting Manual 2024

A practical guide to the application of Dutch accounting standards

December 2023

Foreword

The Deloitte External Reporting Manual 2024 provides a practical guide to the application of NL GAAP. This manual briefly discusses key legal provisions and standards for preparing NL GAAP financial statements. NL GAAP means the Dutch legal requirements and case law on reporting together with the Dutch Accounting Standards.

Dutch entities may prepare financial statements in accordance with either NL GAAP or IFRS, with the exception of companies listed on a regulated market in the EEA (e.g. Euronext Amsterdam), which should apply IFRS in the consolidated financial statements. This manual is not primarily focused on IFRS. For that, please refer both to other (IFRS-related) Deloitte publications and Deloitte's dedicated website on IFRS (www.iasplus.com). However, we do mention for each topic the significant differences between NL GAAP and IFRS. As this manual is primarily aimed at entities applying NL GAAP, it does not address additional requirements applicable to listed entities and other public interest entities. These include additional requirements for the management board report (including sustainability reporting), the supervisory board report, the compensation statement and specific aspects, such as the manner of publication and supervision by the AFM. Separate publications have been prepared for this purpose, which can be found on the Dutch jurisdiction page of www.iasplus.com (under the tab: publications/member firm publications/Netherlands). However, this manual does indicate which exemptions listed entities and other public interest entities cannot take advantage of. Furthermore, the specific requirements for the management board report, supervisory board report and compensation statement are shown on the Deloitte External Reporting Checklist.

Practical examples are given for each topic. For the benefit of medium-sized and small entities, the institutional exemptions for these entities are also discussed for each topic. Publication exemptions for medium-sized and small entities are not covered in this manual. For these, please refer to the Deloitte External Reporting Checklist. Reporting by micro-sized entities is specifically addressed in Chapter 39. This edition of the manual primarily uses the Dutch Accounting Standards (DAS bundle, 2024 edition and the DASsmall bundle, 2024 edition, applicable to reporting periods beginning on or after 1 January 2024). This manual does not address reporting by entities in special industries as mentioned in Section 6 of the Dutch Accounting Standards, except for reporting by commercial foundations and associations (Chapter 40) and non-commercial foundations and associations (Chapter 41).

The annex of legal texts and decrees further enhances the reference function and accessibility of this manual. The texts of this manual were completed on 31 December 2023.

The editors of this manual would welcome any comments and remarks you may have that might enhance the quality of this manual (ckimenai@deloitte.nl).

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Deloitte
External Reporting Manual 2024

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List of abbreviations used

AFM	Autoriteit Financiële Markten	Netherlands Authority for the Financial Markets
Article	(wets)artikel	article, or section of a law
AMvB	Algemene maatregel van bestuur	Order in council
BAW	Besluit actuele waarde	Decree on current value (*Besluit actuele waarde*)
BFW	Besluit fiscale waarderingsgrondslagen	Decree on tax measurement principles (*Besluit fiscale waarderingsgrondslagen*)
BMJ	Besluit modellen jaarrekening	Decree on annual accounts format (*Besluit modellen jaarrekening*)
BV	Besloten vennootschap	Private limited company
NCC	Burgerlijk Wetboek	Netherlands Civil Code (*Burgerlijk Wetboek*)
CSRD	Corporate Sustainability Reporting Directive	Corporate Sustainability Reporting Directive
CV	Commanditaire vennootschap	Limited partnership
DMS	directeur-grootaandeelhouder	Director and major shareholder
DNB	De Nederlandsche Bank	The Dutch Central Bank
EC	Europese Commissie	European Commission
EU	Europese Unie	European Union
EEA	Europese Economische Ruimte (alle landen van de Europese Unie, Liechtenstein, Noorwegen en IJsland)	European Economic Area (all European Union countries, Liechtenstein, Norway and Iceland)
EFRAG	European Financial Reporting Advisory Group	European Financial Reporting Advisory Group
ESRS	European Sustainability Reporting Standard(s)	European Sustainability Reporting Standard(s)
FAF	Financieel Toetsingskader	Financial Assessment Framework
IASB	International Accounting Standards Board	International Accounting Standards Board
IAS	International Accounting Standard(s)	International Accounting Standard(s)
IFRS	International Financial Reporting Standard(s)	International Financial Reporting Standard(s)
IFRS-EU	De door de IASB vastgestelde en door de Europese Commissie goedgekeurde standaarden	Standards adopted by the IASB and endorsed by the European Commission
IFRS-SME	IFRS for Small and Medium-sized Entities	IFRS for Small and Medium-Sized Entities
CoC	Kamer van Koophandel	Chamber of Commerce
CGU	Kasstroomgenererende eenheid	Cash-generating unit
EM	Memorie van toelichting	Explanatory memorandum
NFRD	Non-Financial Reporting Directive	Non-Financial Reporting Directive
NL GAAP	Titel 9 Boek 2 BW, jurisprudentie en de Richtlijnen voor de jaarverslaggeving	Title 9 Book 2 NCC, case law and the Dutch Accounting Standards
NV	Naamloze vennootschap	Public limited company
PIE	Organisatie van openbaar belang	Public interest entity
dDAS	ontwerp-Richtlijn voor de jaarverslaggeving	draft Dutch Accounting Standards
DAS	Richtlijn voor de jaarverslaggeving voor middelgrote en grote rechtspersonen	Dutch Accounting Standard for medium-sized and large entities
DAS bundle	Richtlijnen voor de jaarverslaggeving voor middelgrote en grote rechtspersonen	Dutch Accounting Standards for medium-sized and large entities
DASsmall	Richtlijn voor de jaarverslaggeving voor micro- en kleine rechtspersonen	Dutch Accounting Standard for micro-sized and small entities
DASsmall bundle	Richtlijnen voor de jaarverslaggeving voor micro- en kleine rechtspersonen	Dutch Accounting Standards for micro-sized and small entities
RVU	Regeling vervroegde uittreding	Early retirement scheme
SB	Raad van commissarissen	Supervisory Board
SEC	Sociaal Economische Raad	Social and Economic Council (*Sociaal-Economische Raad*)
SPE	Special Purpose Entity	Special Purpose Entity
Stb.	Staatsblad	Bulletin of Acts and Decrees
VOF	Vennootschap onder firma	General partnership

Wacc	Weighted average cost of capital (gemiddelde vermogenskostenvoet)	Weighted average cost of capital
Vpb Act	Wet op de vennootschapsbelasting 1969	Corporate Income Tax Act 1969 (*Wet op de vennootschapsbelasting 1969*)
Wft	Wet op het financieel toezicht	Financial Supervision Act (*Wet op het financieel toezicht*)
WFBV	Wet op de formeel buitenlandse vennootschappen	Formally Foreign Companies Act (*Wet op de formeel buitenlandse vennootschappen*)
WOR	Wet op de ondernemingsraden	Works Councils Act (*Wet op de ondernemingsraden*)
Wta	Wet toezicht accountantsorganisaties	Audit Firms Supervision Act (*Wet toezicht accountantsorganisaties*)
Wtfv	Wet toezicht financiële verslaggeving	Financial Reporting Supervision Act (*Wet toezicht financiële verslaggeving*)
Wtp	Wet toekomst pensioenen	Future Pensions Act (*Wet toekomst pensioenen*)

Summary of changes in laws and regulations and other changes

This summary outlines the changes in laws and regulations, which mainly consist of legislative changes and amendments to the Dutch Accounting Standards for both medium-sized and large entities and micro-sized and small entities. This summary contains the changes applicable for reporting periods starting from 1 January 2024 (earlier application is recommended, unless otherwise indicated) and the changes to be applied from earlier reporting periods, to the extent that these changes were not already stated in the External Reporting Manual 2023. This summary takes into account the DAS Statements issued by the Dutch Accounting Standards Board up to the time of completion of the texts of this manual (31 December 2023).

This manual, and therefore this summary, disregards the amendments to the Dutch Accounting Standards covering special branches of industry[1], except for amendments relating to commercial foundations and associations and to non-commercial foundations and associations.

Finally, this summary discusses the most significant other changes in this manual compared to the External Reporting Manual 2023.

1 Changes in legislation

1.1 Adjustments to the limits of the size criteria

The obligations to prepare, disclose, and audit the annual accounts of entities primarily depend on the size of an entity, which is determined by three criteria (asset value, net revenue, and number of employees). The limits for these have been laid down in the EU Accounting Directive (2013/34/EU). This is further elaborated on in paragraph 1.5.

In October 2023, the European Commission decided to raise the limits for the first two criteria. Thus, the following limits are now included in the EU directive:

	Micro-sized entity	Small entity	Medium-sized entity	Large entity
Asset value	≤ € 450.000	≤ € 7.500.000*	≤ € 25.000.000	> € 25.000.000
Net revenue	≤ € 900.000	≤ € 15.000.000*	≤ € 50.000.000	> € 50.000.000
Number of employees	< 10	< 50	< 250	≥ 250

*This concerns the maximum allowable limits by member states

The EU Member States must apply the adjusted amounts no later than for financial years beginning on or after 1 January 2024. Member States have the option to already apply the adjusted amounts for financial years beginning on or after 1 January 2023. The adjustments still need to be implemented in Title 9 of Book 2 of the Dutch Civil Code. As of the closing of the texts of this manual (31 December 2023), it is not yet precisely known how the adjusted limits will be applied in the Netherlands. On 22 December 2023, the Council of Ministers adopted the draft Implementation Decision Directive increasing the limits, after which the draft decision will be submitted to the Council of State for advice. The draft decision includes a 25% increase in the limits, and also makes use of the option to apply the increased limits already for the financial year 2023.

1.2 Corporate Sustainability Reporting Directive

On 5 January 2023, the Corporate Sustainability Reporting Directive ("CSRD") came into effect. The EU law requires Member States to transpose the CSRD into national legislation on or before 5 July 2024. In the second half of 2023, a draft proposal for the Implementation Decree on Sustainability Reporting Directive was published and put out for consultation in the Netherlands. The CSRD imposes sustainability reporting requirements and is a review of the current Non-Financial Reporting Directive ("NFRD"). The new Directive is part of the European Green Deal, in which

[1] Special branches of industry in the Dutch Accounting Standards for medium-sized and large entities are banks, insurance companies, pension funds, premium pension institutions, investment entities, cooperatives, commercial foundations and associations, not-for-profit organisations, housing associations, fundraising organisations, healthcare institutions and educational institutions.

the European Commission expressed its ambition to be climate neutral by 2050 *and* to promote economic growth. The most important implications of the CSRD are:

- an extension of the scope to all large entities as well as all listed companies (except for listed micro-sized entities);
- an obligation to have an external auditor or an independent assurance services provider provide an opinion on whether the sustainability reporting complies with the requirements;
- the introduction of detailed reporting requirements;
- the obligation for companies to "tag" the reported sustainability information according to an electronic classification system.

See paragraph 1.1.6.3.4 for a more detailed description of (the implications of) the CSRD.

The current sustainability reporting guidelines (NFRD; implemented in the Netherlands by means of the "Decree on the disclosure of non-financial information" of 14 March 2017) only apply to large PIEs having more than 500 employees. The new sustainability guidelines (CSRD) will take effect from financial year 2024 for entities already falling within the scope of the NFRD. For financial years from 2025, the CSRD will apply to all large entities, whether or not they are PIEs and without the 500-employees threshold. The plan is to subject small and medium-sized listed entities to this obligation from financial year 2026.

1.3 Electronic filing

Dutch entities must publish adopted annual reports and accounts by filing them with the Trade Register at the office of the Chamber of Commerce. According to the Decree on electronic filing Trade Register (*Besluit elektronische deponering Handelsregister*), financial statements of micro-sized, small, and medium-sized entities must be filed electronically via SBR (Standard Business Reporting).

Large entities
For large entities, the Decree on electronic filing Trade Register does not include an obligation to file documents electronically via SBR for the time being. A draft amendment to the Decree was published on 11 May 2022 for the purpose of an internet consultation. The amendment proposes that large entities and associated medium-sized entities will also have to file documents electronically via SBR from financial year 2023. The amendment to the Decree has not yet come into force. According to the Chamber of Commerce's website, this obligation is expected to come into effect from financial year 2025.

1.4 Pillar 2 – Income Taxes

In October 2021, more than 135 jurisdictions, including the Netherlands, agreed to the OECD (Organisation for Economic Cooperation and Development) framework for addressing the tax challenges arising from the digitalization of the economy. To this end, the OECD has developed the so-called 'Pillar Two model rules'. In the Netherlands, the bill 'Minimum Tax Act 2024' (*Wet minimumbelasting 2024*) was passed by the Senate on 19 December 2023 and published in the Dutch Government Gazette on 27 December 2023. Therefore, the Dutch legislation on Pillar 2 income taxes was enacted on 27 December 2023, and substantively enacted on 19 December 2023. The law has come into effect as of 31 December 2023 and applies to financial years starting on or after 31 December 2023, thus (in most situations) from financial year 2024. The law applies to multinational and domestic groups with a (consolidated) group turnover of more than EUR 750 million.

For the financial statements, there are already disclosure requirements for the 2023 financial year, the year in which the legislation was substantively enacted. These are included in DASB Statement 2023-14 'Draft paragraphs on Pillar 2 income taxes'. In addition, from the financial year 2024, the Pillar 2 income tax payable for that financial year must be accounted for in the profit and loss account. It is expected that the draft paragraphs included in this statement will be definitively established in the first quarter of 2024. For a more detailed description, refer to paragraphs 17.1, 17.4 and 17.9.

1.5 Disclosure of income tax and legal basis for AMvBs

On 30 December 2023 the Act Implementing the Income Tax Disclosure Directive (*Implementatiewet Richtlijn openbaarmaking winstbelasting*) (parliamentary paper 36 157) came into effect. The bill creates a new legal basis for

AMvBs in a new legal article, Article 2:391a of the NCC. In addition, the law manages the implementation of an EU directive (Directive (EU) 2021/2101) on the disclosure of income tax information by certain undertakings and branches through an AMvB based on this new legal article.

Legal basis for AMvBs
The bill (contrary to what its name suggests) does not implement the aforementioned EU Directive, but merely prepares its implementation by creating a legal basis for implementation by means of an AMvB. The implementation of this EU directive has been used to adapt the legal basis for AMvBs on annual (financial) reports. This enables a fast and effective implementation of future EU directives, including the CSRD discussed in paragraph 1.2 of this chapter.

To this end, Article 2:391(5) and (6) and Article 2:392(1)(a) NCC are recast and expanded in a new, replacement statutory provision (Article 2:391a NCC). This new article regulates that further rules on the obligations to include information in the management board report may be set by AMvB, as well as - in implementation of binding EU legal acts - rules on obligations regarding annual reports and related statements. In particular, the rules may pertain to:

a. the content of the information, the separate annual report and the statements;
b. the responsibility of the management board and the supervisory board for compliance with the obligations;
c. the obligation to have the information, the separate annual report and the statements audited by an auditor or audit firm as referred to in Article 2:393 NCC or by another third party and to the disclosure of the results of that audit;
d. the method of enforcement of the obligations;
e. compliance with a code of conduct to be designated by AMvB and to the content, disclosure and audit of a corporate governance statement.

The following AMvBs that were based on Articles 2:391 and 2:392a NCC before the bill came into effect will now partly be based on the new Article 2:391a NCC:

- Decree on the content of management board reports;
- Decree on Article 10 of the Takeover Bids Directive (*Besluit artikel 10 Overnamerichtlijn*);
- Decree on establishing audit committees (*Besluit instelling auditcommissie*);
- Decree implementing disclosure requirements for the capital requirements and investment firms directives (*Besluit uitvoering publicatieverplichtingen richtlijnen kapitaalvereisten en prudentieel toezicht beleggingsondernemingen*);
- Decree on reporting payments to authorities;
- Decree on disclosure of non-financial information (*Besluit bekendmaking niet-financiële informatie*).

Disclosure of income tax
The purpose of the EU Directive 2021/2101 is to promote the transparency of income tax payments made by multinational companies worldwide. The EU Directive aims to ensure that companies behave responsibly in the area of income taxation and contribute to welfare by paying their fair share of tax where they carry out their activities and make their profits. The EU Directive requires companies with consolidated revenue of more than EUR 750 million to annually prepare and publish a separate income tax report. The implementation AMvB *Implementatiebesluit Richtlijn openbaarmaking winstbelasting* will apply to financial years beginning on or after 22 June 2024.

The implementation of EU Directive 2021/2101 significantly expands the scope of companies required to disclose income tax information. The European Union has previously introduced country-by-country reporting in the banking sector (through EU Directive 2013/36) as well as in the extractive industry and in the logging of primary forests (through EU Directive 2013/34). The latter has been implemented in the Netherlands by the Decree on reporting payments to governments (*Besluit rapportage van betalingen aan overheden*) (see paragraph 1.8).

The (draft) AMvB that regulates the disclosure of information about corporate tax (the aforementioned *Implementatiebesluit Richtlijn openbaarmaking winstbelasting*) was presented to the House of Representatives in October 2023.

1.6 Temporary COVID-19 Act for Justice and Security

In 2020, the emergency legislation "Temporary provisions for the Ministry of Justice and Security in connection with the COVID-19 outbreak" (*Tijdelijke voorzieningen op het terrein van het Ministerie van Justitie en Veiligheid in* *verband met de uitbraak van Covid-19*; hereinafter: the temporary Act) was published in response to the coronavirus outbreak and its consequences. The temporary Act was originally due to expire on 1 September 2020. Since then, the temporary Act has been extended for two months at a time. The temporary Act’s expiration date was no longer extended as per 1 February 2023.

2 Amendments to the Dutch Accounting Standards applicable to reporting periods beginning on or after 1 January 2024

2.1 Changes for medium-sized and large entities

The Dutch Accounting Standards for medium-sized and large entities (DAS) include several new standards and clarify existing ones. The changes apply to reporting periods beginning on or after 1 January 2024. Earlier application is recommended for all new standards.

2.1.1 Reporting when there is uncertainty about going concern

The Dutch Accounting Standards Board has added several clarifications to DAS 170 'Discontinuity and material uncertainty about going concern’.

The main clarification concerns the manner in which the degree of uncertainty should be assessed in situations where an entity is expected to no longer be able to meet its obligations on its own. This is important for determining the extent of uncertainty about going concern. In that case, it is important to determine whether additional cooperation from stakeholders can be obtained. Consider, for example, the possibility of obtaining financial support from a shareholder or reaching a payment arrangement with a creditor. If necessary additional cooperation is possible but has not been confirmed at the time of preparing the annual accounts, there is an increased degree of uncertainty about going concern. In that situation, it should be assessed whether or not there is a material uncertainty. The conclusion could be that there are (1) concerns about going concern, but no material uncertainty, or (2) there is material uncertainty about going concern.

This results in four different continuity scenarios which are included in an overview in an annex to DAS 170. For each scenario, it is indicated which principles should be applied and what explanations are required. The scenarios are:

1. no uncertainty about going concern;
2. concerns about going concern, but no material uncertainty;
3. material uncertainty about going concern; and
4. inevitable discontinuity.

The overview is added as an annex to chapter 2. The clarifications are incorporated in paragraph 2.12.

2.1.2 Cash flow statement – Classification of bank borrowings

Drawdowns and repayments of bank borrowings is generally considered cash flows from financing activities. Bank borrowings, therefore, are generally not considered cash equivalents. Following IFRS, the Dutch Accounting Standards Board has now stated in DAS 360 'Cash Flow Statement' that current account positions at banks, which are immediately due on demand and form an integral part of an entity's cash management, are included in the cash flow statement as part of the cash equivalents. Such current account positions are often characterized by the fact that the account balance frequently fluctuates between positive and negative. If the balance is always negative, it is not a case of cash management but of financing activities. This is further explained in paragraph 25.3.1.

The 'cash and cash equivalents' as presented in the cash flow statement also deviates on another point from the definition of 'cash' as presented in the balance sheet: cash equivalents are not included in cash as presented in the balance sheet. ‘Cash and cash equivalents’ in the cash flow statement are defined as: cash (cash money, bank account balances, bills of exchange and cheques, immediately due deposits) and short-term very liquid assets. The term 'short-term very liquid assets' has been replaced by 'cash equivalents'. These are highly current financial assets that can be easily converted into liquid assets without restrictions and for which there are no significant risks of value changes. This has been incorporated in paragraph 25.3.1.

If the ‘cash and cash equivalents’ in the cash flow statement deviates from the ‘cash’ presented in the balance sheet, a numerical reconciliation between the two amounts already had to be included. To this has now been added that the components of the cash and cash equivalents must be stated in the notes to the cash flow statement. These components can be (1) the cash, (2) cash equivalents and (3) bank borrowings that meet the aforementioned conditions. Paragraph 25.5 discusses the notes to the cash flow statement.

2.1.3 Classification and presentation of financial instruments as equity or liabilities

In the consolidated financial statements, financial instruments should be classified as equity or liabilities in accordance with economic reality. In the company-only financial statements, it is also allowed to classify financial instruments as equity or liabilities based on their legal form. This can result in a difference between the company-only and consolidated equity. The guidelines for this classification have changed on two points:

1. when classifying in accordance with economic reality: a clarification of what should be understood by 'profit-dependent distributions' to be able to classify instruments as equity. This issue often arises with preference shares; and
2. when classifying based on the legal form: clarification of the way instruments should be presented as equity if those instruments would classify as liabilities based on economic reality.

The first point is further explained in paragraph 21.8.2, including a number of examples. The second point is further discussed in paragraph 14.3.1.

2.1.4 Recognition of intercompany transactions

The Dutch Accounting Standards Board has restructured DAS 260 'Recognition of intercompany transactions in financial statements'. The new structure is intended to enhance the readability and comprehensibility of the standard. The new standard does not contain any substantial changes. However, some points have been clarified. This includes:

- elimination of losses;
- presentation of elimination amounts; and
- elimination in cases of negative net asset value.

The new structure is incorporated in chapter 15 of this handbook.

2.1.5 Transactions not part of a Business Combination

The standards do not contain explicit provisions for the recognition of transactions that are agreed upon as part of an business combination but are not part of the business combination. Consider, for example, the settlement of transactions that are part of an existing relationship between the acquiring and acquired party. Another example includes compensations to employees or former owners of the acquired entity for future services. The Dutch Accounting Standards Board has now determined that the acquiring party, based on economic reality, assesses whether such transactions should be recognised as separate transactions or as part of the acquisition. This can significantly influence the recognition of those separate transactions and the size of the goodwill. Paragraph 31.3 discusses this further and illustrates it with an example.

2.1.6 Reverse dilution resulting in control

Reverse dilution refers to the situation where a subsidiary repurchases its own shares, thereby increasing the relative interest of the remaining shareholders. As a result, a remaining shareholder can obtain control. The standards have clarified that when obtaining control as a result of reverse dilution, there is a step-by-step acquisition that must be recognised in the consolidated financial statements in accordance with DAS 216 'Business Combinations'. See paragraph 31.3.6.

2.2 Changes for micro-sized and small entities

The Dutch Accounting Standards for micro-sized and small entities (DASsmall) include several new standards and clarify existing ones. The changes apply to reporting periods beginning on or after 1 January 2024. Earlier application is recommended for all new standards.

2.2.1 Reporting when there is uncertainty about going concern

Just like for medium-sized and large entities, the Dutch Accounting Standards Board has also made clarifications in the paragraph 'Discontinuity and material uncertainty about going concern' of DASsmall A2.2. The main clarification concerns the manner in which the degree of uncertainty should be assessed in situations where an entity is expected to no longer be able to meet its obligations on its own. We refer to the amendments for medium-sized and large entities.

2.2.2 Classification and presentation of financial instruments as equity or liabilities

In the DASsmall, reference is made to the DAS for this subject. Therefore, the amendments described in point 2.1.3 for medium-sized and large entities also apply to micro-sized and small entities.

2.2.3 Recognition of intercompany transactions

In the DASsmall, reference is made to the DAS for this subject. Therefore, the amendments described in point 2.1.4 for medium-sized and large entities also apply to micro-sized and small entities.

2.2.4 Recognition of Business Combinations

In the DASsmall, reference is made to the DAS for this subject. Therefore, the amendments described in points 2.1.5 and 2.1.6 for medium-sized and large entities also apply to micro-sized and small entities.

2.2.5 Financial statements based on tax accounting principles

Micro-sized and small entities are allowed to apply tax accounting principles when preparing the financial statements. In the DASsmall, guides are included for the use of tax accounting principles by micro-sized entities and small entities. These guides clarify that if goodwill resulting from the acquisition of shares is recognised in equity in the tax return, this recognition is followed in the financial statements based on tax accounting principles. See also paragraph 38.4.

3 Other changes to this manual

The main other changes incorporated in this manual compared to the previous edition are the following:

- further elaboration on the information on a more balanced ratio of men and women in senior management (paragraph 1.1.6.3.4);
- clarification on the determination of the functional currency for foreign operations (paragraph 4.2);
- further explanation of the recognition of a (partial) sale of a foreign operation (paragraph 4.4.2);
- further elaboration of the presentation in the profit and loss account of hedged exchange differences (paragraph 4.7);
- clarification of the recognition of exchange differences on non-monetary balance sheet items (paragraph 4.3.3);
- change in the Dutch Accounting Standards regarding the reversal of negative goodwill (paragraph 6.3.1) and the disclosure requirements of negative goodwill (paragraph 6.3.2);
- clarification of the recognition of restoration costs of tangible fixed assets (paragraphs 7.3.2 and 7.3.4);
- further elaboration on the determination of a provision for investments in associates with negative equity (paragraph 9.2.6);
- clarification of the disclosure requirements for construction contracts (paragraph 12.9);
- presentation of receivables in relation to cash pooling (paragraph 13.2.2);
- distributions by public limited liability entity (NV) and private limited liability entity (BV) in conflict with the balance sheet test (paragraph 14.2.4);

- presentation in the profit and loss account of the effect of changes in the discount rate of provisions (paragraph 16.6);
- applicability of the 'initial recognition exemption' for the recognition of deferred taxes in the initial recognition of a transaction that does not affect the accounting profit or loss nor the taxable profit or loss (paragraph 17.4);
- update regarding the Future Pensions Act (Wet toekomst pensioenen) and related compensation payments (paragraph 18.4.4);
- addition of two examples regarding the traceability of directors' remuneration (paragraph 18.8);
- clarification of 'trade date accounting' versus 'settlement date accounting' (paragraph 21.5.3);
- further elaboration of the disclosure requirements of the risks of financial instruments (paragraph 21.10.1);
- further elaboration of cancellation and early settlement of share-based payments provided to employees (paragraph 28.9.1) and share-based payments within a group (paragraph 28.11.1);
- concise explanation of the special provisions for cross-border mergers (existing rules) and cross-border demergers and conversions (new rules) (paragraph 32.3);
- addition of a short retrospective on the concept of a group (paragraph 33.1) and on the concept of a personal holding (paragraph 33.2.2); and
- clarification of the inclusion in the consolidation scope of a Trust Foundation (*Stichting Administratiekantoor*) (paragraph 33.4.1).

1 Annual reporting in general

1.1 General consideration of laws and regulations

1.1.1 Introduction

Title 9 Book 2 NCC
The basis of Dutch accounting and reporting law is Title 9 Book 2 of the Netherlands Civil Code ("NCC"). The provisions of Title 9 Book 2 NCC, like similar rules in other European Union Member States, had been based on the Fourth and Seventh EC Company Law Directives since the 1980s. These EC Directives are a result of the European effort to harmonise accounting and reporting rules. In later years, some other EC directives in the field of accounting and reporting rules were published and incorporated into the NCC. These later EC directives include specific provisions for financial institutions, such as banks and insurance companies, which are not covered in this manual.

A new EU Accounting Directive was issued by the EU on 26 June 2013 (Directive 2013/34/EU). It replaces the Fourth and Seventh EC Directives on company-only and consolidated financial statements. As a result of the new EU Accounting Directive, Title 9 Book 2 NCC was amended in a number of respects, with effect from 2016. For example, the EU Accounting Directive requires goodwill to be capitalised (Article 24(3)(c)).

The EU Accounting Directive aims to reduce the administrative burden for small and medium-sized entities. For instance, the disclosure requirements for the financial statements of small entities have been greatly reduced and a category of "micro-sized entities" has been introduced. Micro-sized entities only have to prepare a simplified balance sheet and profit and loss account and do not have to include notes. In addition, the limits that determine whether a company is small, medium-sized or large have been adjusted.

IFRS-EU
In 2005, Title 9 Book 2 NCC was substantially amended. This change in the law was the direct result of amendments to the EC directives in 2001 and 2003 related to the European policy to enable application of European-approved IAS/IFRS ("IFRS-EU") in the financial statements of European entities. This removed legal barriers that prevented the voluntary use of IFRS-EU in the financial statements of European entities. European listed entities have been required by an EC regulation from 2002 (also known as "IAS or IFRS Regulation") to prepare consolidated financial statements based on IFRS-EU since the 2005 financial year. The amendment of Title 9 Book 2 NCC in 2005 also made it possible for unlisted Dutch entities to voluntarily apply IFRS-EU.

Decree on current value
The law allows certain assets and liabilities to be measured at current value. The Decree on current value contains further rules on the content, limits and method of application of measuring certain assets and liabilities at current value in the financial statements.

Decree on annual accounts format
Title 9 Book 2 NCC contains rules and regulations on how to prepare and publish financial statements. An important part is formed by the Decree on annual accounts format. This Decree contains detailed format outlines for the presentation of the financial statements of public limited liability entities and private limited liability entities. These are mandatory formats to be applied for the balance sheet and profit and loss account.

Decree on tax measurement principles (*Besluit fiscale waarderingsgrondslagen*)
Small entities and micro-sized entities may voluntarily apply tax accounting principles in the (commercial) financial statements (Article 2:396(6) and Article 395a(7) NCC, respectively). Further rules on the application of tax accounting principles are set out in the Decree on tax measurement principles. The application of tax measurement principles is discussed in more detail in Chapter 38.

Public interest entities
Public interest entities (PIEs) as referred to in Article 2:398(7) NCC are subject to various additional regulations. As this manual is not aimed at these entities, it does not address these additional requirements. These include additional requirements for the management board report, the supervisory board report, the compensation statement and specific aspects such as the manner of publication and supervision by the Netherlands Authority for the Financial Markets.

Public interest entities as referred to in Article 2:398(7) NCC cannot make use of a number of exemptions. Where this is the case, it is indicated in the description of the relevant exemption. Public interest entities as referred to in Article 2:398(7) NCC are:

a. entities which have securities admitted to trading on a regulated market of an EU Member State (listed entities);
b. credit institutions;
c. insurance companies; and
d. entities designated by order in council because of their size or function in society.

Regulated market of an EU Member State
As described in Article 4(21) of Directive 2014/65/EU, a regulated market is a multilateral system operated and/or managed by a stock exchange organisation that brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with Title III of this Directive.

Markets such as Euronext Amsterdam, Frankfurter Wertpapier Börse and Euronext Paris are regulated markets. Markets such as Alternext, which is aimed at listing securities of small and medium-sized entities, are not. As required by Article 56 of MiFID II, a searchable register of regulated markets in the European Economic Area (EEA) is maintained on the website of the European Securities and Markets Authority (ESMA), to be found on https://registers.esma.europa.eu/publication/. Select 'MiFID/UCITS/AIFMD/EUSEF/EUVECA/ECSPR entities' and 'Regulated market' under 'Entity type'.

PIEs designated by AMvB
To date (December 2022), no entities have been designated as PIEs within the meaning of Article 2:398(7) NCC.

However, organisations have been designated as PIEs under the Audit Firms Supervision Act (*Wet toezicht accountantsorganisaties*). Through the Decree on the designation of public interest entities (*Besluit aanwijzing organisaties van openbaar belang*) of 26 June 2019 (date of entry into force 1 January 2020), the Decree on supervision of audit firms (*Besluit toezicht accountantsorganisaties*) includes the following organisations as PIEs for the purposes of the Audit Firms Supervision Act:

- network operators as referred to in Article 1(1)(k) of the Electricity Act 1998 or Article 1(1)(e) of the Gas Act;
- admitted institutions as referred to in Article 1(1) of the Housing Act (housing associations), which own more than 5,000 rental units on two consecutive reporting dates, without interruption thereafter on two consecutive reporting dates;
- three science policy institutions: the Royal Netherlands Academy of Arts and Sciences, the Dutch Research Council and the KB National Library;
- pension funds that on two consecutive reporting dates, without interruption thereafter on two consecutive reporting dates, qualify as large funds as referred to in Article 35a(5)(b) of the Decree implementing the Pensions Act (*Besluit uitvoering Pensioenwet*) and the Compulsory Professional Pension Schemes Act (*Wet verplichte beroepspensioenregeling*).

When auditing these entities, audit firms should observe additional safeguards to promote audit quality. The additional requirements are mainly aimed at auditors and audit firms and mainly concern the audit firm's quality control system, its independence and the degree of supervision.

1.1.2 Dutch Accounting Standards

The management of a Dutch entity must, pursuant to Article 2:362 NCC, be guided in its choice of accounting principles by the purpose of the financial statements and generally acceptable standards. For several decades now, the Dutch Accounting Standards Board has given significant substance to these standards by preparing Dutch Accounting Standards for medium-sized and large entities and for micro-sized and small entities. The Dutch Accounting Standards do not have the status of a legal provision and therefore have no binding force (DAS 100.407). Nevertheless, these standards occupy an important place in the elaboration of the standards mentioned in the law. Rulings in financial statement proceedings by the Supreme Court and the Enterprise Division confirm the importance of the Dutch Accounting Standards "as an authoritative source of guidance on standards to be considered".

In the opinion of the Dutch Accounting Standards Board, the Dutch Accounting Standards, and in particular the authoritative statements contained therein, generally contribute to the legally required insight into equity and profit or loss. The Dutch Accounting Standards Board expects these authoritative statements to be deviated from only if there are good grounds for doing so. The Dutch Accounting Standards Board considers these good grounds to be present in any case if these deviations are intended to improve the insight provided by the financial statements and achieve this aim (DAS 100.407).

1.1.3 Scope of application

Introduction
The accounting requirements of Title 9 Book 2 NCC apply to the following entities (incorporated under Dutch law) (Article 2:360(1) NCC):

- public limited liability entities;
- private limited liability entities;
- cooperatives;
- mutual guarantee associations;
- commercial associations; and
- commercial foundations.

A commercial association or foundation – within the meaning of accounting and reporting rules – exists if an association or foundation operates one or more companies that must be registered in the Trade Register and whose annual net revenue exceeds a certain minimum amount, which is half the amount referred to in Article 2:396(1b) NCC. For financial years from 2015 onwards, the minimum amount is €6 million (see also paragraph 40.2.3). Such "entrepreneurial" associations or foundations are fully subject to Title 9 Book 2 NCC (Article 2:360(3) NCC).

The legal accounting requirements of Title 9 Book 2 NCC also apply to a partnership firm or a limited partnership of which all partners who are fully liable for the debt are joint stock companies under foreign law. Therefore, a partnership firm of which all partners or a limited partnership of which all managing partners are foreign joint stock companies is fully subject to Title 9 Book 2 NCC (Article 2:360(2) NCC).

Formally Foreign Companies Act (*Wet op de formeel buitenlandse vennootschappen*)
Pursuant to the Formally Foreign Companies Act, the provisions of Title 9 Book 2 NCC apply to so-called "formally foreign companies" incorporated under foreign, non-EU law in the Netherlands. The Formally Foreign Companies Act prescribes that some Dutch rules, including the preparation and publication of financial statements, are mandatorily applicable to a foreign, non-EU company that performs all or almost all of its activities in the Netherlands and, furthermore, has no actual connection with the State under whose law it was incorporated. After a ruling by the European Court of Justice in 2003 concluded that some parts of the Formally Foreign Companies Act were in breach of the EC Treaty and the Eleventh EC Directive, remedial legislation was developed and an amended Formally Foreign Companies Act entered into force in 2005. As a result, only formally foreign companies incorporated under the law of a non-EU Member State, for example a Delaware Corporation or an Antillean company (with no real connection to its country of origin) which conducts all or almost all of its business in the Netherlands, are covered by the operation of the Formally Foreign Companies Act and therefore the provisions of Title 9 Book 2 NCC. Companies incorporated under the law of an EU Member State are not subject to the financial statements provisions of the Formally Foreign Companies Act.

As a result of Brexit, since 1 January 2021 the Formally Foreign Companies Act has also applied to companies incorporated under UK law, at least if they carry out their activities entirely or almost entirely in the Netherlands and have no actual connection with the UK. Because these UK companies must comply with Title 9 Book 2 NCC, NL GAAP or IFRS-EU should be applied. UK GAAP may therefore not be applied in that case.

Transfer of seat
An entity incorporated under Dutch law that falls within the scope of accounting and reporting rules (Article 2:360 NCC), such as a private limited liability entity, can move its actual place of business (transfer of seat) abroad (e.g. to Belgium or Aruba). The registered office of a Dutch entity, the legal "domicile" (Article 1:10 NCC), is and remains, however, the place (in the Netherlands) where this entity (at incorporation) has its seat according to its articles of association or internal rules. Therefore, this Dutch entity, regardless of the transfer of the actual establishment

(company) abroad, remains subject to the Dutch legal provisions regarding the presentation and publication of the financial statements.

Voluntary application of Title 9 Book 2 NCC
In practice, it regularly occurs that entities that are not mentioned in Article 2:360 NCC (see paragraph 1.1.3) and to which Title 9 Book 2 NCC does not, therefore, apply, wish to voluntarily apply Title 9 Book 2 NCC when preparing the financial statements. These include partnership firms, limited partnerships with Dutch partners or non-commercial foundations or associations. It is important to realise that Title 9 Book 2 NCC does not formally apply to these entities. Also, certain articles of Title 9 Book 2 NCC may not be relevant, for instance because of the different legal form. Voluntary application of Title 9 Book 2 NCC when preparing financial statements means that sections 2 to 6 of Title 9 Book 2 NCC must be complied with if and insofar as they are applicable. For example, the provisions of Title 9 Book 2 NCC regarding the classification of equity (Article 2:373 NCC) do not apply to a partnership firm or limited partnership.

Sections 2 to 6 of Title 9 Book 2 NCC set out the requirements for the balance sheet, the profit and loss account and the notes thereto, including the accounting policies. This can be summarised under the heading of "accounting policies for financial reporting". The notes to the financial statements should therefore (in the accounting policies for preparing financial statements) avoid giving the impression that all the provisions of Title 9 Book 2 NCC have been applied. By disclosing that the financial statements have been prepared on the basis of the accounting principles for financial reporting of Title 9 Book 2 NCC, that goal is achieved. Because Title 9 Book 2 NCC does not formally apply and because of the fact that only the provisions on accounting principles for financial reporting of Title 9 Book 2 NCC are applied, this wording is very specific.

The Dutch Accounting Standards are a further elaboration of the generally acceptable accounting principles. This means that if an entity voluntarily applies Title 9 Book 2 NCC when preparing its financial statements, the relevant Dutch Accounting Standards also apply.

1.1.4 Preparation and signing of financial statements

1.1.4.1 Preparation of financial statements

Annually preparing financial statements is the legal responsibility of the management board of the entity. This fits within the Dutch legal system where the management board, subject to restrictions according to the articles of association, has the task of managing the entity. The management board should act in the interest of the entity and its business. Primarily as part of its management role, the management board has a number of powers and obligations. For example, the management board is responsible for managing the finances, keeping proper records of the entity's assets and activities and retaining administrative data for the legal period of, currently, seven years (Article 2:10 NCC).

The management board of a public limited liability entity or a private limited liability entity has the duty to prepare the financial statements and the management board report (Articles 2:101 and 210 NCC). By preparing the financial statements, the management board also accounts for its policies and management. The financial statements so prepared should then be adopted. The adoption of the financial statements is part of the legal powers of the general meeting, in the case of a public limited liability entity or a private limited liability entity, or the members' meeting, in the case of a cooperative, mutual guarantee association or commercial association. In the case of a commercial foundation, the financial statements are adopted by the body authorised to do so under the articles of association or the supervisory body. If there is no supervisory body, the financial statements are adopted by the management board of the commercial foundation (Article 2:300(3) NCC). The financial statements of a private limited liability entity may also be adopted by the signature of all management board members and supervisory board members, if, among other things, all management board members are also shareholders (see also paragraph 1.1.5).

If there are important reasons for doing so, the entity may apply to the Ministry of Economic Affairs for exemption from the obligation to prepare and publish financial statements. For example, if an entity is dissolved, is granted suspension of payments or is declared bankrupt, exemption may be granted. The decision-making on such an exemption request by the Minister has been mandated to the Netherlands Enterprise Agency. The entity that has obtained this exemption from the Ministry should – instead of financial statements – publish a copy of the exemption by filing it with the Trade Register (Article 2:394(5) NCC). A public limited liability entity whose securities are listed on a regulated market cannot be granted an exemption from preparing financial statements (Article 2:101(7) NCC).

Incidentally, the exemption relates only to the financial statements; the obligation to prepare and publish the management board report remains.

Dissolution and preparation of financial statements
There is sometimes ambiguity about preparing financial statements in a situation where an entity is dissolved or insolvent. If the competent body of an entity has passed a resolution to dissolve, and "in liquidation" is mentioned after the name (see Article 2:19(5) NCC), or if an entity is insolvent, the legal obligations for preparing the financial statements continue to apply in principle. If an entity is voluntarily dissolved, commonly referred to as liquidation, dissolution will be done by an irrevocable resolution to dissolve (dissolution resolution) of the competent body. As a result of this dissolution resolution, the liquidation phase is opened. During the liquidation phase, the entity continues to exist to the extent necessary for liquidation of equity. There are different views in practice as to whether the financial statement provisions of Title 9 Book 2 NCC still apply in the liquidation phase. There are two views:

a. The rules regarding the financial statements and their preparation and publication no longer apply, as this task rests with the management board, which as a body has been dissolved and been replaced by the liquidator(s). The liquidator's task is to wind up the affairs of the entity. The "obligation to prepare financial statements" has been replaced, as it were, by the duty of the liquidator to prepare and publish "accounts" (and a "plan of distribution").
b. During the liquidation period, which can be lengthy, proper "bookkeeping" and also periodic reporting are required. The preparation, adoption and publication of financial statements therefore remains mandatory until the liquidation is completed.

In a legal sense, view b is correct. An entity "in liquidation" continues to exist until the effective end of the liquidation period. The provisions of Title 9 Book 2 NCC apply to an entity regardless of whether it is in liquidation or not. The practical question then is who or which body should prepare those financial statements and who can issue any audit engagement. In principle, the obligation to prepare financial statements rests on the liquidator, as they have the same duties as a management board member (Article 2:23a(1) NCC).

In practice, view a appears to be the most common course of action. In that instance, no financial statements will be drawn up for the year of dissolution; preparing a closing or liquidation balance sheet will suffice. In expedited liquidations ("turboliquidations") where the entity no longer has any income, there seems to be little against this approach. In other liquidations, the liquidator is expected to prepare the closing "accounts" in the foreseeable future, and filing them in the form of a closing balance sheet will suffice, so no more financial statements will be prepared or published. This is partly because the practical usefulness of the financial statements of an entity "in liquidation" is considered to be low, as all users of the financial statements of an entity "in liquidation" will or can be aware of the liquidation. For past financial years prior to dissolution, the obligation to prepare and file financial statements remains. Before dissolution, this obligation rests on the management board. After dissolution it rests on the liquidator.

The Bankruptcy Act distinguishes two situations with regard to an entity that is insolvent: suspension of payments and bankruptcy. With regard to the financial statement obligation, these two situations should also be distinguished. The entity may have been granted suspension of payments as at the end of the financial year or it may have been declared bankrupt as at the end of the financial year. The granting of suspension of payments is intended as a measure for deferred payment, similar to a "payment holiday". Suspension is a measure that is formally intended to be temporary, so suspension does not affect the duty to prepare and publish financial statements. In the situation where a suspension has been granted and an administrator has therefore been appointed, practice shows that other measurement basis are frequently used in the financial statements. This is because experience shows that in the Netherlands, suspension of payments is almost always followed by bankruptcy. If the financial statements can no longer be prepared on the basis of a going concern assumption, accounting principles based on discontinuity must be applied. Paragraph 2.12 discusses reporting aspects in the event of discontinuity in more detail.

If a bankruptcy is declared, a receiver is appointed in the process. Among the powers vested in the receiver are those normally vested in the management board under the law. The management and disposition of the equity of the bankrupt entity is in the hands of the receiver. Even after bankruptcy, there is formally an obligation to prepare and publish financial statements. Based on case law, there is an assumption that financial statement obligations lapse after bankruptcy. This is because it cannot be said that they rest with the receiver after the bankruptcy: the system of the Bankruptcy Act does not imply that the receiver can be obliged to prepare financial statements. However, case law also shows that even in bankruptcy, the management board of the entity remains responsible for preparing and publishing financial statements for the period (financial years) prior to the actual moment of declaring bankruptcy. In practice, the receiver does not prepare financial statements (any longer); instead one or more bankruptcy reports are filed with the court. After the closure of the bankruptcy, the receiver will file a so-called final financial report with the court, if, after verification, no liquidation and distribution is taking place. The following details must be registered with the Trade Register:

- the court order granting suspension of payments;
- setting aside of any such court order; as well as
- the end of suspension of payments or bankruptcy.

1.1.4.2 Signing of financial statements

The prepared financial statements ("the original copy of the financial statements") must be signed by the management board members and supervisory board members. If the signature of one or more management board members or supervisory board members is missing, this must be disclosed, stating the reason for the absence of signature.

Case law (Court of Appeal of 's-Hertogenbosch dated 13 September 2022, ECLI:NL:GHSHE:2022:3141) has confirmed that the financial statements need not prepared and signed at the same time: preparation and signing are two separate acts. If the management board decides that the document prepared by it or on its behalf is the prepared financial statements, then it is known as "the prepared financial statements", even though those financial statements have not yet been signed. Preparation will usually be evidenced by a record in the minutes of the relevant management board meeting. So it may be that financial statements have already been prepared but not yet signed. Signing will in any case have to take place before the financial statements are presented to the general meeting or members' meeting (see paragraph 1.1.5).

Insofar as the signatures required by law have been placed on the original copy of the financial statements, the names of the signatories on the other copies will suffice. If a signature is missing on the original copy, the reason will also be stated on the other copies (Article 15 of the Decree on annual accounts format). If the management is performed by an entity, the signing of the financial statements will include the name of the entity-director and the signing on behalf of that entity will have to be done by one or more natural persons authorised to do so.

1.1.5 Adoption of financial statements

For the purpose of adopting the financial statements, the prepared financial statements should be presented to the general meeting or members' meeting.

The financial statements cannot be adopted if the body authorised to adopt them has not been able to take cognisance of the auditor's report, unless a lawful reason why the report is missing is disclosed under Other information (Article 2:393(7) NCC). Any adoption resolution without such a lawful ground is void. The auditor's report should – if it relates to an entity subject to audit – be attached to the financial statements. If no auditor's report is included in the Other information, a notice should be included as to why the auditor's report is missing (Article 2:392(1)(a) NCC). The only lawful ground for the auditor's report being missing is that the financial statements are not subject to legally required audit. Micro-sized and small entities are exempt from the legally required audit requirement for financial statements (see paragraph 1.6.3).

The entity must give all shareholders or members the opportunity to inspect the prepared financial statements by making these financial statements (and the management board report and Other information) available for inspection at the offices of the entity. Shareholders or holders of share certificates (or members) should be able to obtain copies of these documents free of charge. For a public limited liability entity and private limited liability entity, the law stipulates that articles of association may not contain any provision to the effect that resolutions to adopt the financial statements are subject to the prior approval of another corporate body or third parties (Articles 2:101(4) and 210(4) NCC). This provision emphasises that decision-making on the adoption of the financial statements belongs exclusively to the general meeting. Also, the articles of association of a public or private limited liability entity may not contain provisions including instructions or binding proposals for the financial statements, or any item of the financial statements (Articles 2:101(5) and 210(6) NCC). However, the articles of association may provide that a body of the company other than the general meeting has the power to determine what part of the profit or loss of the financial year is to be reserved or how the loss is to be recognised (Articles 2:101(6) and 210(7) NCC).

In the case of a private limited liability entity, an alternative procedure is possible if all shareholders are also management board members of the company. If so, the signing of the financial statements by all management board members and supervisory board members also counts as adoption of the financial statements. Other conditions are that all persons entitled to attend meetings have been given the opportunity to inspect the prepared financial statements and have agreed to this simplified adoption. This method of adoption also implies the discharge of the management board members and supervisory board members. The articles of association may exclude this method of adoption of the financial statements (Article 2:210(5) NCC).

Amended adoption of financial statements
With the adoption resolution of the general meeting, the financial statements prepared by the management board become "the financial statements of the entity", within the meaning of the law on entities (Book 2 NCC). The adopted financial statements of a public or private limited liability entity serve as the basis for other legal acts, such as the purchase of own shares or the payment of dividends. In a public or private limited liability entity, the power to adopt the financial statements also means that the general meeting can amend the financial statements (or have them amended) before adopting them. In practice, this amendment can only happen if the general meeting instructs the management board to amend the financial statements. Two conditions must also be met, namely that the amendment sought by the general meeting is in line with accounting and reporting rules and that the auditor, where there is a statutory audit obligation, provides a (new) auditor's report on the fairness of the amended financial statements. The general meeting then adopts the amended financial statements.

Role of supervisory board members
Legally, there is only the adoption of the financial statements by the general meeting. In statutory two-tier companies, the supervisory board has the task of pre-approving major management board resolutions as well as appointing and dismissing management board members. The general meeting appoints and dismisses the supervisory board. Thus, the supervisory board does not have the power to adopt the financial statements, but its involvement is reflected in the signing of the financial statements by all management board members and supervisory board members.

Discharge
The NCC provides that the resolution to adopt the financial statements must be separate from the resolution to grant discharge to management board members and/or supervisory board members. This applies to all public limited liability entities, cooperatives, mutual guarantee associations and commercial associations. In private limited liability entities where all shareholders are also management board members of the company, an alternative procedure is possible, in which the signing of the financial statements by all management board members and supervisory board members also counts as adoption and discharge of the management board members and supervisory board members. The articles of association may exclude this method of adopting the financial statements (Article 2:210(5) NCC).

The resolution to adopt the financial statements and the resolution to grant discharge should (except for situations where the above alternative procedure is followed) appear separately on the agenda of the general meeting or members' meeting. The adoption (or not) of the financial statements is thus entirely separate from the discharge (or not) of one or more management board members or supervisory board members. In this way, the deadlock that used to occur in the past, namely shareholders refusing to adopt the financial statements because they did not want to grant the management board discharge, is a thing of the past. Shareholders can decide separately on whether or not to adopt the financial statements and whether or not to grant discharge.

Company-only and consolidated financial statements
In Title 9 Book 2 NCC, financial statements mean: "the company-only financial statements comprising the balance sheet and profit and loss account with notes, and the consolidated financial statements if the entity prepares consolidated financial statements" (Article 2:361(1) NCC). This separates the company-only and consolidated financial statements. This separation allows different sets of standards to be used for company-only and consolidated financial statements, e.g. basing the company-only financial statements on the standards of Title 9 Book 2 NCC and the consolidated financial statements on IFRS-EU.

Since the consolidated financial statements fall under the term "financial statements", all regulations pertaining to "financial statements" apply unchanged to consolidated financial statements as well. The same applies to the publication of financial statements. The legal definition of financial statements implies that the financial statements of the entity are the company-only financial statements if there is no obligation to prepare consolidated financial statements. If there is such an obligation, the financial statements of the entity consist of the company-only financial statements as well as the consolidated financial statements.

It can be seen from the statutory procedure for adopting financial statements that it is not possible, for example, to adopt the company-only financial statements and not the consolidated financial statements. It also follows from the spirit of the law that the company-only and consolidated financial statements must be adopted simultaneously and then also published simultaneously within eight days of adoption. It follows that the adoption of the financial statements should be included in a single resolution at the same general meeting.

It is recommended, but not formally necessary, to actually include the company-only and consolidated financial statements in "one booklet". However, if the financial statements are published in accordance with Article 2:394 NCC, they must still be published as a whole with the Trade Register; this is for the sake of consistency between the company-only and consolidated financial statements. The date of adoption of the financial statements will have to be noted on the copy for publication. This date will have to be the same for company-only and consolidated financial statements. If the company-only or consolidated financial statements are published separately (alongside publication with the Trade Register), it must be unambiguously stated that it is the publication of part of the financial statements, with reference to the publication with the Trade Register. The scope of the auditor's report(s) on the financial statements must also be disclosed (Article 2:395(2) NCC). The law offers the possibility of issuing a separate auditor's report for the company-only financial statements and for the consolidated financial statements (Article 2:393(5) NCC).

Auditor presence at the general meeting of a public limited liability entity
The auditor engaged to audit the financial statements of a public limited liability entity is authorised to attend and speak at the general meeting that decides on the adoption of the financial statements (Article 2:117(5) NCC).

1.1.6 Components of the annual report

1.1.6.1 General

The statutory accounting requirements cover:

- the financial statements;
- the management board report;
- the supervisory board report; and
- the Other information.

The collective term "annual accounts" or "annual report" is also used for the entirety of the management board report, the supervisory board report, the financial statements and the Other information. The supervisory board report forms part of the annual accounts of listed companies and is not covered in this manual. In Title 9 Book 2 NCC, the financial statements are understood to mean the company-only financial statements consisting of the balance sheet and the profit and loss account with the notes, and the consolidated financial statements if the entity prepares consolidated financial statements (Article 2:361(1) NCC).

1.1.6.2 Financial statements

According to generally acceptable standards, the financial statements must provide such an insight that a responsible opinion can be formed on equity and profit or loss, and, as far as the nature of the financial statements allows, on the solvency and liquidity of the entity (Article 2:362(1) NCC). This is the main rule of Title 9 Book 2 NCC that underlies the Dutch Accounting Standards. In addition, the law gives many specific rules. If the disclosures are insufficient according to the specific provisions of the law, additional disclosures should be made in the financial statements (Article 2:362(4) NCC). In principle, this has been addressed by the inclusion of additional disclosure requirements in the Dutch Accounting Standards. Nevertheless, in specific situations the entity may need to include additional information in the financial statements to comply with Article 2:362(4) NCC (DAS 110.108).

Only in exceptional cases, namely if this is necessary to provide the required insight into equity and profit or loss, can the specific requirements of Title 9 Book 2 NCC be deviated from ("derogation"). The reason for this deviation and (to the extent necessary) its effect on equity and profit or loss must be disclosed in the notes (Article 2:362(4) NCC). The authoritative statements of the Dutch Accounting Standards Board can only be deviated from if there are good grounds for doing so. The Dutch Accounting Standards Board considers these good grounds to be present in any case if these deviations are intended to improve the insight provided by the financial statements and achieve this aim (DAS 100.407).

1.1.6.3 Management board report

1.1.6.3.1 General

Introduction
The management board of an entity must prepare a written management board report. Like the financial statements, the management board report must be made available for inspection by the shareholders (Article 2:101(1) NCC for a public limited liability entity and Article 2:210(1) NCC for a private limited liability entity). It is recommended, but not formally necessary, to include the financial statements and the management board report in "one booklet", adding the Other information (see also paragraph 1.1.6.5). The management board report must not contradict the financial statements (Article 2:391(4) NCC). Micro-sized entities and small entities are exempt from preparing a management board report (Article 2:395a(6) NCC and Article 2:396(7) NCC). The management board report covers the entity and the group entities whose financial data are included in its financial statements. The management board report must give a fair view of (Article 2:391(1) NCC):

- the situation at the reporting date;
- developments during the financial year; and
- the profit or loss.

Language
The management board report is drawn up in Dutch, unless the general meeting has decided on the use of another language (Article 2:391(1) NCC). However, under Article 2:394(1) and (4) NCC, the other languages are limited to French, German or English if the management board report has to be published. The management board report must also be prepared in the same language as the financial statements or in Dutch (DAS 190.111).

References to the financial statements
The management board report must include references to and additional explanations of items in the financial statements if this is necessary for a fair view in the management board report (Article 2:391(4) NCC). This information can be integrated with the information required by Article 2:391(1) NCC. Incidentally, legislative history shows that it is not the legislator's intention that the management board report should contain information that belongs in the financial statements (Explanatory Memorandum to draft bill 29 737, no. 3, p. 25).

Use of key figures, key ratios and/or multi-annual overviews
DAS 430 "Key figures, key ratios and multi-annual overviews" applies to the use of key figures, key ratios and/or multi-annual overviews in the management board report. See paragraph 30.11.

1.1.6.3.2 Content of the management board report: general

The rules for the content of the management board report are set out in DAS 400 "Management board report". This standard has a "stack structure", first addressing rules applicable to all medium-sized and large entities. Additional rules for specific companies are then discussed. The structure is as follows:

- rules for all medium-sized and large entities (paragraph 1.1.6.3.3);
- additional rules for large entities (paragraph 1.1.6.3.4);
- additional rules for certain public interest entities (these are not covered in this manual, see paragraph 1.1.1 under "Public Interest Entities");
- additional rules for listed companies (these are not covered in this manual, see paragraph 1.1.1 under "Public Interest Entities").

This structure aims to make it easier to determine which rules apply to a specific company.

The management board report should specifically address the entity's specific situation. Overly general and vague statements should not be used (DAS 400.1004).

1.1.6.3.3 Content of the management board report: rules for all medium-sized and large entities

The management board report of a medium-sized or large entity should address the following topics (DAS 400.1001):

1. policy, course of business and previous expectations;
2. objectives and core activities;
3. corporate structure and staffing;
4. financial developments;
5. risks and risk management;
6. culture and behaviour – soft controls;
7. financial instruments risk management policy;
8. application and compliance with codes of conduct;
9. research and development;
10. future expectations; and
11. other.

The information provided on these topics must relate to the entity and its business (DAS 400.1012).

Policy, course of business and previous expectations (DAS 400.1.01)
In the management board report, the management board reports in writing on the entity's course of business and the policy pursued by the entity. This may involve the use of infographic, visual and multimedia elements.

The management board report must provide information on the significant components of the policy pursued concerning the entity and its affiliated companies (i.e. on a consolidated basis). Attention should also be paid to the actual development during the reporting period of significant matters about which expectations were expressed in the previous management board report or about which a significant degree of uncertainty was disclosed. In this context, it is recommended to mention significant deviations from trends mentioned in the previous management board report.

Objectives and core activities (DAS 400.1.02)
The entity should provide information in the management board report on the objectives and activities concerning the entity and its affiliated companies (i.e. on a consolidated basis). This information should include at least:

- the objective, which may or may not be set out in a "mission statement"; and
- an indication of the (core) activities of the business run by the entity, with its main products, services, geographical areas, categories of customers and suppliers and the international chain in which it operates.

Corporate structure and staffing (DAS 400.1.03)
The entity should provide information in the management board report on the corporate structure and staffing concerning the entity and its affiliated companies (i.e. on a consolidated basis). This information should include at least:

- the legal structure of the company, including the group structure and the applicability of the structure regime;
- the internal organisational structure; and
- staffing.

Financial developments (DAS 400.1.04)
Discussion in the management board report should address at least the following aspects through a balanced and comprehensive analysis:

- developments during the financial year;
- the revenue and profit or loss achieved;
- the situation at the reporting date (solvency and liquidity);
- the principal risks and uncertainties; and
- cash flows and financing needs.

This analysis should be consistent with the size and complexity of the entity and group entities pursuant to Article 2:391(1) NCC.

The management board report will include references to and additional explanations of items in the financial statements if this is necessary for a true and fair view in the management board report (Article 2:391(4) NCC). Additional disclosures in the management board report may not replace disclosures in the financial statements (DAS 400.1042).

In the above discussion, it is important, for the purpose of insight, to distinguish between revenue and profit or loss achieved from core activities, secondary activities and activities that have already been discontinued or from which the company intends to withdraw in due course (see also paragraph 30.5 "Discontinuance of operations"). It is recommended that attention be paid here to the development of both absolute amounts and the company's position in relevant markets.

Risks and risk management (DAS 400.1.05)
The risks and risk management disclosures address the following aspects:

a. principal risks and uncertainties;
b. risk appetite;
c. measures to control the principal risks and uncertainties;
d. impact of risks on profit or loss and/or financial position;
e. materialised principal risks in the past financial year;
f. improvements, made or planned, to the risk management system; and
g. embedding of risk management.

The comprehensiveness of the information to be provided is partly determined by the size and complexity of the entity and its activities and the related risks and uncertainties.

Re a. Principal risks and uncertainties
The management board report provides a description of the principal risks and uncertainties facing the entity (Article 2:391(1) NCC). DAS 400 elaborates on this legal requirement. According to the Dutch Accounting Standards Board, it is not about giving an exhaustive account of all possible risks and uncertainties, but rather a selection and representation of the *principal* risks and uncertainties facing an entity (and the consolidated companies). Uncertainties arise from the total or partial lack of information about, insight into or knowledge of an event, its consequences, or the likelihood of an event occurring. Risks are the impacts of uncertainties on achieving objectives. In selecting the principal risks and uncertainties, at least the following categories are important:

- strategy: risks and uncertainties, often with an external orientation/root cause, that impede the achievement of the entity's strategy and/or business plans and may affect its long-term objectives (e.g. related to or associated with the entity's strategy or governance, technological or social developments and sustainability aspects);
- operational activities: risks and uncertainties that affect the effectiveness and efficiency of the entity's operational activities and therefore mainly relate to the processes within the entity and that may affect short-term objectives (e.g. related to the internal organisation and accounting procedures, the implementation of new information systems and the entity's remuneration system);
- financial position: risks and uncertainties relating to the entity's financial position (e.g. exchange rate risks, currency risks, interest rate risks and uncertainties in its ability to raise funding);
- financial reporting: risks and uncertainties affecting the reliability of internal and external financial reporting (e.g. uncertainties in complex attribution issues, the degree of subjectivity in measurement issues and risks regarding the design of financial reporting systems);
- laws and regulations: risks and uncertainties arising from laws and regulations (both internal and external) that have a direct impact on the entity's organisation and/or business processes (e.g. risks and uncertainties of operating in an environment with many and complex regulations, uncertainties related to insider misuse and risks due to changing tax legislation).

Re b. Risk appetite
The entity should provide an outline description of its willingness to hedge or not hedge risks and uncertainties (so-called risk appetite). The degree of risk appetite guides the decision whether or not to take measures to control risks and uncertainties.

Re c. Measures to control the principal risks and uncertainties
The entity should provide a description of the measures taken to control the principal risks and uncertainties, if

possible with a qualitative description of the expected effectiveness of the measures taken. If control measures are not in place for one or more of the principal risks and uncertainties, this fact should be explained.

Re d. Impact of risks on profit or loss and/or financial position
The entity should provide a description of the expected impact on the profit or loss and/or financial position should one or more of the principal risks and uncertainties occur, if possible based on sensitivity analyses.

Re e. Materialised principal risks in the past financial year
The entity should provide a description of the risks and uncertainties that had a significant impact on the entity in the past financial year, and their consequences for the entity.

Re f. Improvements, made or planned, to the risk management system
The entity should provide information on whether, and if so what, improvements have been or are being made to the entity's risk management system.

Re g. Embedding of risk management
The entity should preferably indicate how the system of risk management is embedded in the organisation.

Culture and behaviour – soft controls (DAS 400.1.06)
The entity should preferably indicate what measures the entity has taken ("soft controls") to influence the culture and its employees' behaviour and motivation.

Financial instruments risk management policy (DAS 400.1.07)
With regard to the entity's use of financial instruments, the management board report must pay attention to the objectives and policy in terms of management of risks concerning financial instruments, insofar as it is significant for the assessment of the entity's assets, liabilities, financial position and profit or loss (Article 2:391(3) NCC). Attention should be paid to the policy on hedging risks associated with all major types of financial and other transactions and the price, credit, liquidity and cash flow risks incurred by the entity. The use of financial instruments as a tool to hedge financial risks can itself be a source of risk.

The information relates to the entity as well as the group entities whose financial data are included in the consolidated financial statements. Where this information has been provided in the financial statements, it is recommended that a specific reference to the relevant passage in the financial statements be included in the management board report.

Application of and compliance with codes of conduct (DAS 400.1.08)
The entity indicates whether specific codes of conduct are followed and what they are, and whether these codes of conduct are followed on a mandatory or voluntary basis.

In the management board report (or in the table of contents), the entity includes a reference to available information on compliance with the codes of conduct (e.g. to the website). Codes of conduct expressly include international conventions and guidelines, such as the ILO Declaration on Fundamental Principles and Rights at Work, the International Labour Organization (ILO) Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, the OECD Guidelines for Multinational Enterprises and the International Chamber of Commerce (ICC) Guide to Responsible Sourcing.

Research and development (DAS 400.1.09)
In the management board report, disclosures are made regarding research and development activities (Article 2:391(2) NCC). See Chapter 5 "Intangible fixed assets" for a description of what is meant by research and development. This applies whether or not development costs are recognised under intangible fixed assets on the balance sheet.

According to the Dutch Accounting Standards Board, it is recommended that this should include information on the nature of the research and development activities and their significance for the entity's position and expected course of business. It may be important to distinguish research into basic and applied research.

Research and development activities are very significant for some entities (including so-called high-tech companies). In certain cases, this information may qualify as "sensitive" from a competition point of view, as a result of which some restraint may be appropriate. The law (Article 2:391(2) NCC), however, does not permit exemptions from the requirement to provide information on research and development activities, except for disclosures regarding the expected course of business (see "Future expectations" below).

The Dutch Accounting Standards Board also points out that the amount charged to the profit or loss of the financial year for research and development costs must be shown in the financial statements (under DAS 210.506, see paragraph 5.6).

Future expectations (DAS 400.1.10)
In the management board report, disclosures are made regarding (Article 2:391(2) NCC):

1. the expected course of business;
2. research and development activities; and
3. special events that need not be taken into account in the financial statements.

Re 1. The expected course of business
The paragraph on the expected course of business addresses the following aspects in particular, insofar as important interests do not preclude this:

- investments;
- funding;
- staffing; and
- the conditions on which the development of revenue and profitability depend.

The provision "insofar as important interests do not preclude this" implies that the entity does not have to make disclosures that could seriously harm it in commerce. There is therefore a tension between the information users would like to obtain regarding the management board's view of the stated opportunities and risks on the one hand and the information the management board can provide without seriously damaging the interests of the entity on the other. Usually, "important interests" will arise in those cases where strategic considerations warrant particular prudence, for example:

- plans to acquire other companies for which negotiations have not yet reached an advanced stage; and
- strategic plans to market new products or enter new markets.

The entity cannot then be expected to make specific disclosures such that other market parties would have access to important information prematurely, according to the Dutch Accounting Standards Board.

With regard to investments, funding and staffing, this is the part of the policy that is mostly determined for the long term. The disclosures in the management board report therefore concern the expected consequences of the policy pursued in these areas. Quantitative projections – to the extent possible – can be useful, but are not required.

The circumstances on which the development of revenue and profitability depends include relevant internal and external developments, such as prospects and intentions regarding products, services and markets that are important for the entity, including related opportunities and risks. Risks include concentrations with respect to customers or markets, for example. In that context, the relative position in the relevant markets is also important. Information on other relevant aspects, in particular those involving special risks, e.g. related to specific currencies or due to government measures, should also be provided in this context. The development of revenue and profitability partly depends on circumstances beyond the entity's control. In this regard, the requested disclosures may be limited to the circumstances that, in the opinion of the management board, will particularly determine the development. The circumstances on which the development of revenue and profitability depends may – besides those directly relating to the entity – also include such circumstances as national and international economic developments and general government measures.

Re 2. Research and development activities
See the explanation given above for a more detailed account of the required disclosures regarding research and development activities.

Re 3. Special events that need not be taken into account in the financial statements
It should be disclosed to what extent special events that need not be taken into account in the financial statements have affected expectations. This refers to events subsequent to the reporting date.

Other topics (DAS 400.1.11)
Depending on the relevance to users of the management board report and financial statements, the following topics may also be of interest in the management board report:

- marketing and distribution;
- internal control of processes and procedures;
- quality control;
- provision of information internally and externally; and
- automation.

1.1.6.3.4 Content of the management board report: additional rules for large entities

Non-financial performance indicators – corporate social responsibility (DAS 400.2.01)
In order to give a true and fair view, the law requires a balanced and comprehensive analysis of the situation on the reporting date, developments during the financial year and the profit or loss. This analysis should be in line with the size and complexity of the entity and group entities. Where necessary for proper understanding, the analysis includes both financial and non-financial performance indicators, including environmental and human resources matters (Article 2:391(1) NCC).

In general, according to the Dutch Accounting Standards Board, corporate activities have three societal aspects, namely environmental, social and economic. By consciously considering these three aspects and the related effects of corporate activities, the entity contributes to sustainable development. This is often referred to as corporate social responsibility. In this respect, the Dutch Accounting Standards Board recommends including in the management board report information on the main issues of corporate social responsibility relevant to the entity, including the entity's national and international supply chain management. Responsible supply chain management means the voluntary – but not free from obligation – commitment and involvement of entities to positively influence the social and/or environmental policies of their suppliers and customers.

It is primarily up to the entity to shape corporate social responsibility in dialogue with its social environment. The diversity of situations means that it is not really possible or desirable to prescribe exactly and uniformly how entities ought to shape this. However, transparency can be expected in this area, with the entity having tailored the choice of relevant societal aspects, and the information to be included thereon in the management board report, to the information needs of stakeholders. The entity determines whether, and if so how, information on relevant societal aspects of business are included in the management board report, as well as which societal aspects are considered most relevant. To this end, a framework is provided by the Dutch Accounting Standards Board in DAS 400.2, which aims to provide support and direction for reporting on societal aspects of business and the development of such reports. For further elaboration of this framework, authoritative national and international frameworks, standards and guides (including the 'Social Reporting Guide' incorporated in Chapter 920 of the Dutch Accounting Standards for medium-sized and large entities) in the field of sustainability reporting and other reporting of non-financial information can be used.

The corporate social responsibility framework recommended by the Dutch Accounting Standards Board covers a number of aspects. To the extent relevant to the nature of corporate activities, it is recommended that corporate social responsibility reporting address each of the following aspects:

- *general societal aspects*
  These cover the main problems and challenges for the entity, the extent to which these are decisive for the business strategy, the role played in this context by stakeholders in the entity, the interrelationship between the environmental, social and economic aspects included below, as well as societal aspects that are relevant for a good understanding of the national or international chain in which the entity operates and of the products and/or services marketed by the entity (e.g. in relation to safety), as well as information on governance and ethics (e.g. in relation to integrity and combating corruption);
- *environmental aspects*
  These could include: information on energy, material and water use, discharges, emissions and waste. They also

include environmental protection measures to prevent pollution of air, water and soil, as well as the protection and promotion of the quality and intactness of ecosystems;

- *social aspects*
  These could include: information on labour matters, including employment, social security, working conditions and terms of employment. They also include aspects such as health and safety, education and training, diversity and development opportunities. At the same time, social aspects cover information on human rights, fundamental principles and rights at work, respect for local communities and indigenous peoples, as well as information on the entity's social and societal engagement; and
- *economic aspects*
  These include both financial and non-financial aspects. Financial aspects can include the financial contributions to society at large (e.g. in the form of taxes), as well as the entity's financial contributions to its stakeholders such as customers, suppliers, employees, equity providers and government. Non-financial economic aspects include the social creation and dissemination of knowledge through research and development, training and the like.

When reporting on these aspects, it is recommended to distinguish between an entity's own operations and corporate activities, on the one hand, and the national or international chain in which it operates, on the other. An entity's own operations and corporate activities are aspects that the entity can directly control and manage. The national or international chain in which an entity operates concerns aspects that are beyond the legal scope and control of the entity but over which the entity can exert a positive influence (e.g. by participating in sector-wide initiatives or by imposing requirements on the social or environmental policies of suppliers).

It is also recommended to pay attention to (1) the dialogue with stakeholders, (2) the policy pursued in this respect and the principal considerations, (3) organisation (governance structure and management information systems), (4) the implementation of the policy and the results achieved, and (5) expectations regarding internal and external developments that may affect the aforementioned societal aspects of doing business. The inclusion of segment information may be important in this regard.

Sustainability reporting
On 5 January 2023, the Corporate Sustainability Reporting Directive entered into force. Under EU law, Member States must implement the CSRD in national legislation within 18 months after 5 January 2023, i.e. by 5 July 2024 at the latest. In the third quarter of 2023, the Ministry of Finance published and consulted the proposal for the Sustainability Reporting Directive Act. This bill amends the Audit Firms Supervision Act, the Accountancy Profession Act and the Netherlands Civil Code, among other things. In the fourth quarter of 2023, the Ministry of Justice and Security published and consulted the proposal for the Implementation Decree on the Sustainability Reporting Directive. This Decree sets out the scope of sustainability reporting: listed companies (with the exception of micro-sized companies), all other large companies, listed banks and insurance companies regardless of their legal form, and large non-listed banks and insurance companies are required to draw up sustainability reporting.

The CSRD imposes sustainability reporting requirements and is a review of the current Non-Financial Reporting Directive ("NFRD"). The new Directive is part of the European Green Deal, in which the European Commission expressed its ambition to be climate neutral by 2050 *and* to promote economic growth. The idea behind the CSRD is to arrive at a more uniform sustainability reporting system, which will allow investors in particular to better understand the sustainable activities of companies. The principal aim is for investors to increase their investments in sustainable activities in the EU as a result, which explains the cohesion with the sustainable finance agenda. The main implications of the CSRD are explained below.

Scope and effective date
The current sustainability reporting guidelines (NFRD) only apply to large PIEs having more than 500 employees. The new sustainability guidelines (CSRD) will apply to all large entities, regardless of whether they are PIE and without the 500-employees threshold. Specifically, the CSRD will apply to all entities that meet at least two of the three criteria for large entities during two financial years (see paragraph 1.5).

The new guidelines will be effective for reporting periods beginning on or after 1 January:

- 2024 for large PIEs within the meaning of Article 2:398(7) NCC (see paragraph 1.1.1), which also exceed the average of 500 employees per financial year on their reporting date (i.e. the group of entities currently in the scope of the NFRD);

- 2025 for all large entities (as described in paragraph 1.5) as well as large listed companies with the exception of listed companies that have already transitioned in 2024 (see previous bullet);
- 2026 for small and medium-sized listed entities, small and non-complex credit institutions and insurance companies;
- 2028 for non-EU entities with net revenue of more than €150 million in the EU and with at least one EU-based large or listed subsidiary or branch and for non-EU entities with a branch generating net revenue of more than €40 million.

Audit requirement
The CSRD contains an obligation to have an external auditor or an independent assurance services provider provide an opinion on whether the sustainability reporting complies with the requirements. Although the European Commission aims for a similar level of assurance for sustainability reporting as for financial reporting, for now it has determined that a "limited assurance engagement" is sufficient. The European Commission will assess whether the transition from 'limited assurance' to 'reasonable assurance' is feasible for auditors and companies. Depending on this assessment, the European Commission will adopt standards for 'reasonable assurance' by 1 October 2028.

The contents
Under the CSRD, the management board report must include information necessary to understand the company's impacts on sustainability matters, and information necessary to understand how sustainability matters affect the company's development, performance and position. The CSRD requires this information to be included in a dedicated section of the management board report. The Directive then describes eight information elements to be included in this part of the management board report:

a. a brief description of the business model and strategy, including:
   - the resilience of the company's business model and strategy in relation to risks related to sustainability matters;
   - opportunities related to sustainability matters;
   - financial and investment plans to ensure that business model and strategy are in line with the transition to a sustainable economy and with the limiting of global warming and the target of climate neutrality by 2050 according to the Green Deal;
   - how the business model and strategy take account of the interests of stakeholders and of the impacts of the company on sustainability matters;
   - how the above strategy has been implemented;
b. a description of the time-bound targets related to sustainability matters set by the company, including, where appropriate, absolute greenhouse gas emission reduction targets at least for 2030 and 2050 and progress made towards achieving those targets;
c. a description of the role of corporate governance bodies with regard to sustainability matters and the expertise and skills of the individuals who make up these bodies;
d. description of the sustainability policy;
e. information on the existence of bonus schemes related to sustainability criteria offered to members of corporate governance bodies;
f. a description of:
   - due diligence processes implemented by the company to identify adverse impacts with regard to sustainability factors;
   - the principal actual or potential adverse impacts connected with the company's own operations and with its value chain;
   - actions taken to prevent, mitigate or remediate these impacts and the result of such actions;
g. a description of the principal risks related to sustainability matters, including dependencies and how the company seeks to manage those risks;
h. indicators relevant in relation to all of the above.

All the above information should include forward-looking, historical, qualitative and quantitative information.

A subsidiary is not required to include sustainability information in its management board report if the parent entity has already included the sustainability information in its consolidated management board report. The subsidiary's management board report must explicitly report this exemption. Also, in that case, the subsidiary must publish the parent entity's consolidated management board report.

Digitalisation
The CSRD requires companies to prepare their financial statements and management board report in XHTML format and to "tag" the reported sustainability information according to an electronic classification system, which adds to the comparability and digital findability of sustainability information.

Reporting standards
The European Financial Reporting Advisory Group (EFRAG) is responsible for developing reporting standards related to sustainability information, the European Sustainability Reporting Standards (ESRS). EFRAG has been designated by the European Commission as their technical adviser as specified in the CSRD. EFRAG presented the proposed standards to the European Commission on 22 November 2022. The European Commission finalised the standards and adopted the regulation on 31 July 2023. Following the approval of the European Parliament and the European Council, the standards were published in the Official Journal of the European Union on 22 December 2023 by means of a delegated regulation (EU 2023/2772). A delegated regulation has direct effect and does not have to be transposed into the national legislation of the Member States. The standards apply for financial years beginning on or after 1 January, 2024. The set consists of 12 sector agnostic (i.e. applicable to all sectors) applicable standards, namely:

<u>Overarching standards:</u>

- ESRS 1: General requirements;
- ESRS 2: General disclosures;

<u>Thematic standards:</u>

- *Environment*
  - ESRS E1: Climate change;
  - ESRS E2: Pollution;
  - ESRS E3: Water and marine resources;
  - ESRS E4: Biodiversity and ecosystems;
  - ESRS E5: Resource use and circular economy;
- *Social*
  - ESRS S1: Own workforce;
  - ESRS S2: Workers in the value chain;
  - ESRS S3: Affected communities;
  - ESRS S4: Consumers and end-users;
- *Governance*
  - ESRS G1: Business conduct.

EFRAG will develop additional standards in the future, including standards for listed SMEs and sector/industry-specific standards.

Information on a more balanced ratio of men and women in senior management (DAS 400.2.02)
From reporting period 2022, large public and private limited liability entities are subject to the legal requirement to set appropriate and ambitious goals in the form of a target figure with the aim to achieve a more balanced gender ratio (Articles 2:166(2) and 2:267(2) NCC). According to the Explanatory Memorandum (Parliamentary Paper 35 628), 'appropriate' means that the target figure depends on the size of the body in question and on the existing ratio between the number of men and women. 'Ambitious' means that the target figure should aim to make the composition more balanced than the existing situation. So the target figure cannot be zero.

<u>Management board and supervisory board</u>
In any case, the target figure must pertain to the management board and the supervisory board, i.e. separately for both bodies. If both the management board and the supervisory board consist of a single person, the target figure can be set jointly for both bodies. A target figure is not necessary if there is a single management board member and no supervisory board. For one-tier boards, a target figure is set for both executive management board members and non-executive management board members.

Number of management board members	Number of supervisory board members	Target figures
1	No supervisory board	Management board: no target figure
1	1	Merge: aim for 1 woman and 1 man
1	2	Management board: no target figure Supervisory board: aim for 1 woman and 1 man
2	1	Management board: aim for 1 woman and 1 man Supervisory board: no target figure
2	2	Management board: aim for 1 woman and 1 man Supervisory board: aim for 1 woman and 1 man
2	3	Management board: aim for 1 woman and 1 man Supervisory board: aim for at least 1 woman and 1 man

(Source: Explanatory Memorandum to Parliamentary Paper 35 628)

Subtop
In addition, the target figure must relate to the subtop. It is up to the company to decide for which subtop it sets a target figure. For example, for an executive committee or (the first and second layer) senior management positions. The purpose of the expansion to the subtop is to accelerate the flow to the top, according to the Explanatory Memorandum.

Plan
The company must draw up a plan to achieve the goals (Article 2:166(3) and 2:267(3) NCC), which may include, for example, drawing up or amending a profile, setting up a transparent recruitment and selection process and explaining the preferential policy.

Reporting to SER and in the management board report
The number of men and women at the end of the financial year, the goals, the plan and its progress must be reported annually to the SER within ten months after the end of the financial year (Article 2:166(4) and 2:267(4) NCC).

For management board reports covering financial years beginning on or after 1 January 2022, the Decree on the content of management board reports stipulates that this information must also be included in the management board report. It concerns the following information (Article 3d(1) of the Decree on the content of management board reports):

a. the number of men and women serving on the management and supervisory boards at the end of the financial year, as well as the categories of employees in managerial positions to be determined by the company (as prescribed in Articles 2:166(2) and 2:276(2) NCC);
b. goals in the form of target figures (as referred to in Articles 2:166(2) and 2:276(2) NCC);
c. the plan to achieve these goals (as referred to in Articles 2:166(3) and 2:276(3) NCC); and
d. if one or more goals have not been achieved, the reasons.

These disclosures in the management board report allow the company's shareholders to take note of the results and to call the company to account if necessary. Shareholders can also consider the results when determining how to vote on the appointment and reappointment of management board members and supervisory board members. Moreover, when companies report to an external body (the SER), internal and external transparency are increased if they are also required to share that information with their shareholders.

A company belonging to a group is exempt provided that company's head of the group includes the relevant information in its management board report, whether or not for the relevant group entities jointly (Article 3d(2)(a) of the Decree on the content of management board reports).

Temporary provision
The relevant parts of the Decree on the content of the management board reports will expire on 1 January 2030. The information included in Article 3d(1) of this Decree (see section 'Reporting' above) therefore no longer needs to be included in the management board report relating to the financial year starting on or after 1 January 2029.

1.1.6.4 Other Information

The law also requires the management board to add some information of various kinds to the financial statements and management board report in the Other information section. This includes the following information (Article 2:392 NCC):

1. the auditor's report (audit opinion) or a disclosure as to why it is missing;
2. the statutory provisions regarding profit appropriation;
3. the statutory provisions regarding the contribution to the deficit of a cooperative or a mutual guarantee association, insofar as these deviate from the legal provisions;
4. a list of names of persons/parties granted a special statutory right relating to the control in the entity, with a description of the nature of that right. It should be borne in mind that if a special statutory right is embodied in shares or priority shares, the number of these shares held by each rights owner should be disclosed. If this rights owner is an entity, the names of the management board members of this entity must also be disclosed. The stipulation to provide this information on special statutory rights of control may be waived by the Ministry of Economic Affairs upon request – for important reasons – for a maximum of five years each time;
5. a statement of the number of shares without voting rights and the number of shares that do not share in profits or reserves or share only to a limited extent, together with the powers they confer; and
6. a list of existing branches and the countries in which there are branches, as well as their trade name if different from that of the entity.

Micro-sized entities and small entities do not have to add Other information to the financial statements (Article 2:395a(6) and Article 2:396(7) NCC, respectively).

Medium-sized entities do not have to disclose the information under 4. and 5. (Article 2:397(7) NCC).

1.1.7 Comparability of figures

Title 9 Book 2 NCC contains a number of requirements regarding the comparability of financial statements, such as:

- for each item in the financial statements, the corresponding amount for the previous financial year will be disclosed as far as possible, with, where necessary, the amount being revised for the sake of comparability and the deviation resulting from the revision being explained (Article 2:363(5) NCC);
- the layout of the balance sheet and profit and loss account may deviate from that of the previous year only for justified reasons, with disclosure in the notes of the differences and the reasons that led to the deviation (Article 2:363(4) NCC);
- the measurement of assets and liabilities and equity and the determination of the profit or loss may only be based on different accounting principles than in the previous financial year if justified reasons exist (usually referred to as a change in accounting policies). The reason for the change and its significance for the insight into equity and profit or loss must be explained (Article 2:384(6) NCC);
- the combination, breakdown and layout of information must be directed towards the insight that the financial statements are intended to provide (Article 2:363(1) NCC).

See Chapter 3 for more details.

1.1.8 Language

Financial statements may be prepared in a language other than Dutch if the general meeting has so resolved (Article 2:362(7) NCC). However, the financial statements to be published – which will be discussed in more detail below – must be drawn up in Dutch, French, German or English (Article 2:394(1) NCC). The management board report and Other information should be prepared in the same language as the financial statements or in Dutch (DAS 190.111). The Works Councils Act prescribes that Dutch-language financial statements and a Dutch-language management board report and Other information must be provided to the Works Council (Article 31a(2) of the Works Councils Act). This therefore means that every company in which a Works Council has been set up will (in principle) have to prepare Dutch-language documents and therefore publish them in the Dutch language. Incidentally, in practice, this does not preclude the Works Council from also receiving a foreign-language annual report; obviously if no member of the Works Council objects.

1.1.9 Currency unit

If justified by the activities of a company or the international presence of the group to which a company belongs, the financial statements or only the consolidated financial statements may be prepared in a foreign currency unit (Article 2:362(7) NCC). Possible indications for the justified choice of a currency unit other than Dutch could be that the majority of the contracts are concluded in this other currency unit, or that the majority of the financing is arranged in it, or that the accounting records of the entity and those of its group entities are kept in that currency, or that the consolidated financial statements of the entity's parent entity are prepared in that currency unit (DAS 190.103).

Group-related amounts included in the management board report are provided in the same currency unit in which the consolidated financial statements are prepared.

If numerical information in the management board report relates to the entity itself and the currency of the consolidated financial statements is different from the currency in the company-only financial statements, such information should be provided in both currencies. The Other information should use the same currency as the company-only financial statements. However, if the information relates to the group and a different currency has been applied in the consolidated financial statements, it should be disclosed in that other currency (DAS 190.108).

The financial statements may be prepared in a currency unit other than the currency unit in which the shareholders' equity is denominated. In the case of a public limited liability entity, the shareholders' equity is legally denominated in euros and this situation may arise if the financial statements are prepared in a foreign currency unit. In the case of a private limited liability entity, the shareholders' equity can be denominated in a currency unit other than the euro. In financial statements in which a presentation currency is used that differs from the currency in which the issued capital is denominated, the issued capital is stated at the exchange rate at the reporting date (Article 2:373(5) NCC). The notes must then also disclose the exchange rate used as well as the amount of the issued capital in the currency unit in which the shareholders' equity is denominated. For recognition of the translation difference, see paragraph 4.4.1.

1.2 Policies to be applied in the company-only and/or consolidated financial statements

General
Article 2:362(8) NCC allows entities to prepare both company-only and consolidated financial statements in accordance with IFRS-EU. IFRS-EU refers to the standards and interpretations approved by the EC.

An entity can prepare company-only financial statements under IFRS-EU only if the consolidated financial statements are also prepared under IFRS-EU. The table below sets out the possible combinations offered by the law if consolidated financial statements are prepared alongside company-only financial statements. For the possibilities of preparing financial statements in accordance with Title 9 Book 2 NCC in combination with IFRS-SME, see paragraph 1.3. IFRS-SME is not reflected in the table below.

Disclosure on which standards have been used to prepare the financial statements
Pursuant to Article 2:362(10) NCC, an entity discloses in the notes which standards have been used to prepare the financial statements. This means disclosing whether the financial statements have been prepared in accordance with IFRS-EU or with the statutory provisions of Title 9 Book 2 NCC (or possibly in accordance with generally acceptable standards in one of the other Member States of the European Union). This applies to both consolidated and company-only financial statements.

Determining the consolidation obligation
If the company-only financial statements are prepared in accordance with Title 9 Book 2 NCC, it is determined on the basis of Title 9 Book 2 NCC (section 13) whether the entity has to prepare consolidated financial statements. This also applies if the consolidated financial statements are prepared (either mandatorily or voluntarily) in accordance with IFRS-EU. This is different if an entity chooses to prepare company-only financial statements under IFRS-EU. In that case, IFRS-EU can also be used to determine whether consolidation is required. See also paragraph 1.2.4.

Possible combinations
The table below shows the options if an entity prepares both company-only and consolidated financial statements (combinations 1 to 5) and if an entity prepares only company-only financial statements (options 6 and 7).

	Company-only financial statements	Consolidated financial statements
1	Title 9 Book 2 NCC plus Dutch Accounting Standards	Title 9 Book 2 NCC plus Dutch Accounting Standards
2	Title 9 Book 2 NCC without application of the option to use the measurement basis applied in the consolidated financial statements (plus Dutch Accounting Standards)	IFRS-EU
3	Title 9 Book 2 NCC with application of the option to use the measurement basis that the entity has applied in the consolidated financial statements	IFRS-EU
4	IFRS-EU plus applicable articles of Title 9 Book 2 NCC	IFRS-EU
5	Generally acceptable standards in one of the other Member States of the EU if the international presence of its group so justifies	Generally acceptable standards in one of the other Member States of the EU if the international presence of its group so justifies
6	Title 9 Book 2 NCC plus Dutch Accounting Standards	N/A
7	IFRS-EU plus applicable articles of Title 9 Book 2 NCC	N/A

The following paragraphs explain some of the details for each combination. In addition, paragraphs 14.3.7.2 and 14.3.7.3 deal with details of revaluation reserves applicable in multiple combinations. This concerns the revaluation reserve in case of "available for sale" financial instruments and the revaluation reserve when applying a deemed cost (relevant in combination 3 and combination 4). Furthermore, paragraph 2.7 discusses the recognition of subsequent events in the company-only financial statements under combination 3 and combination 4.

1.2.1 Notes to combination 1

If an entity prepares consolidated financial statements in accordance with Title 9 Book 2 NCC and therefore does not apply IFRS-EU, Article 2:362(8) NCC requires that the company-only financial statements are also prepared in accordance with Title 9 Book 2 NCC. If an entity does not choose to apply IFRS-EU in its consolidated financial statements, the rules of Title 9 Book 2 NCC must be followed and may not be deviated from by relying on IFRS-EU.

For some topics, the Standards allow the application of specific standards from IFRS or US GAAP, provided the relevant standards are applied in full. This applies to pensions (see paragraph 18.4.2) or leases (see paragraph 22.1), for example. Full application means that, in principle, all provisions of the relevant standards are followed, but references in the relevant standards to provisions of other standards within that system that are not applied by the entity do not apply, unless explicitly stated in the Standards. These references are read as references to the Standard where that topic is addressed (DAS 100.104a).

Example: Application of IFRS 16 under NL GAAP

Entity A applies IFRS 16 "Leases" (under DAS 292.101, see paragraph 22.1) in its NL GAAP financial statements, but not IFRS 15 "Revenue from Contracts with Customers". For recognition of a sale and leaseback transaction, IFRS 16 requires an entity to apply the provisions of IFRS 15 to determine whether the transfer of an asset results in the transfer of control of the asset (IFRS 16.99). If so, the transfer of the asset is recognised as a sale, and a leaseback is recognised.

A should read the reference in IFRS 16.99 to IFRS 15 as a reference to the terms of DAS 270.110 on the sale of goods, as there is no explicit reference to IFRS 15 in DAS 292.101. If the conditions of DAS 270.110 are met, A recognises the sale and leaseback transaction as a sale and a leaseback in accordance with the provisions of IFRS 16.

1.2.2 Notes to combination 2

If an entity prepares the consolidated financial statements based on IFRS-EU in combination with the company-only financial statements based on Title 9 Book 2 NCC, without applying the option to apply the measurement basis that the entity has also applied in the consolidated financial statements, this will, in many cases, result in differences in equity and profit or loss according to the consolidated financial statements and the company-only financial statements. These differences must be disclosed in the notes to the company-only financial statements (Article 2:389(10) NCC).

The main reason for differences between company-only and consolidated equity and profit or loss in this combination is related to the different accounting principles for determining equity and profit or loss that exist between IFRS-EU and NL GAAP, e.g. recognition of goodwill and pensions. This combination effectively means that consolidated equity and profit or loss are determined in accordance with IFRS-EU, while on a company-only basis the net asset value of the (consolidated) participating interests must be determined on the basis of NL GAAP. This amounts to applying a double accounting policy in the entity's financial statements, which will in many cases lead to an increased administrative burden. For this reason, this combination is rarely applied and combination 3 is preferred in Dutch reporting practice.

1.2.3 Notes to combination 3

1.2.3.1 General

Article 2:362(8) NCC allows the consolidated financial statements to be prepared on the basis of IFRS-EU in combination with the company-only financial statements on the basis of Title 9 Book 2 NCC, applying the measurement basis that the entity has also applied in the consolidated financial statements. The possibility to also apply the measurement basis applied in the consolidated financial statements under IFRS-EU in the company-only financial statements was created by the legislator to allow equity according to the company-only financial statements to be equal to equity according to the consolidated financial statements. This means that in determining the measurement of assets and liabilities and equity (including consolidated participating interests) in the company-only financial statements, the same measurement basis and resulting measurements of the underlying assets and liabilities and equity are used, as included in the consolidated financial statements.

The above also applies to the classification principles affecting the distinction between equity and liabilities (DAS 100.107). This requires the entity applying combination 3 in its company-only financial statements to base the distinction between equity and liabilities on economic reality as required by IFRS-EU (IAS 32.15). By also following the IFRS-EU classification basis in the company-only financial statements, the principle of keeping equity according to the company-only financial statements equal to equity according to the consolidated financial statements is met. This would not be the case if Title 9 Book 2 NCC were followed for the distinction between equity and liabilities. Indeed, DAS 240.207 allows issued financial instruments to be classified as equity or liabilities in the company-only financial statements based on the legal form (see paragraphs 14.2.6 and 21.8).

Article 2:362(9) NCC stipulates that an entity "which prepares the financial statements in accordance with IFRS-EU" only applies a limited number of provisions of Title 9 Book 2 NCC (see paragraph 1.2.4). Here, "the financial statements" should be read as "the company-only financial statements". After all, if only the consolidated financial statements have been prepared in accordance with IFRS-EU, the company-only financial statements have been prepared in accordance with Title 9 Book 2 NCC. In that case, the provisions mentioned in Article 2:362(9) NCC already apply to the company-only financial statements. Article 2:362(9) NCC is therefore not applicable when applying combination 3. In addition, this also means that consolidated financial statements prepared in accordance with IFRS-EU must comply with IFRS-EU but not with the provisions of Title 9 Book 2 NCC.

1.2.3.2 Participating interests

Measurement
The option to apply combination 3 effectively means that an entity prepares company-only financial statements in accordance with the IFRS-EU measurement basis applied in the consolidated financial statements (Article 2:362(8) NCC). This raises the question of how to measure, in the company-only financial statements, participating interests that are consolidated. Indeed, there is no measurement basis for this in the consolidated financial statements. IFRS-EU requires such participating interests to be measured at cost or fair value or according to the equity method in the separate financial statements prepared alongside the consolidated financial statements. When measuring participating interests at cost or fair value a difference would arise between equity according to the company-only financial statements and equity according to the consolidated financial statements. Therefore, DAS 100.108 stipulates that consolidated participating interests in the company-only financial statements under combination 3 are measured according to the net asset value method.

Under the net asset value method, the participating interest is considered a mix of assets and liabilities and equity rather than an indivisible asset. This method reflects the fact that the participating entity has an economic interest in this mix of assets and liabilities and equity of the participating interest.

Transactions between parent entity and consolidated participating interests
If there is a 100% interest, transactions and/or balance sheet positions between the parent entity and its consolidated

participating interest therefore do not lead to differences between equity according to the company-only financial statements and equity according to the consolidated financial statements. The impacts of such transactions and/or balance sheet positions are eliminated. The eliminations as applied in the consolidated financial statements are the starting point for the eliminations in the company-only financial statements in accordance with the principles of DAS 260 "Recognition of intercompany transactions in the financial statements" (see Chapter 15). Examples include (DAS 100.108):

- expected credit loss as prescribed by IFRS 9 on loans to and receivables from the participating interest;
- differences in the recognition method of a lessor and a lessee for a lease between the parent entity and the participating interest in accordance with IFRS 16;
- derivatives entered into by the parent entity where the hedged risk is with the participating interest and hedge accounting is applied in the consolidated financial statements; and
- a financial instrument issued by a participating interest that is partly held by the parent entity, where the participating interest measures this instrument at amortised cost and the parent entity measures it at fair value.

Example: Expected credit loss (extracted from Appendix 1 to DAS 100)

Parent entity A provides a loan of 100 to its consolidated subsidiary B. The expected credit loss determined in accordance with IFRS 9 is 10 at 31 December of year 1. B's net asset value based on combination 3 is 200 as of that date. In the consolidated financial statements, the loan is eliminated and there is no expected credit loss to be recognised.

A's company-only financial statements also do not recognise a loss in the profit and loss account. The measurement difference between the receivable with A (of 90) and the debt as part of the measurement of participating interest B (of 100) is eliminated.

This elimination can be recognised in A's company-only financial statements in accordance with the principles of DAS 260:

- in the carrying amount of the consolidated participating interest. In that case, the carrying amount of the loan provided is 90 and the participation value is 210; or
- as an accrual. The carrying amount of the loan provided is then 90, the participation value is 200 and the carrying amount of the accrued asset is 10.

For practical reasons, elimination is also allowed in A's company-only financial statements:

- in the carrying amount of the loan provided. In that case, the carrying amount of the loan provided is 100 and the participation value is 200.

Example: Differences in recognition method of a lessor and a lessee (extracted from Appendix 1 to DAS 100)

Parent entity A (lessor) enters into a lease contract with consolidated participating interest B (lessee) in respect of certain assets. For the lessor, this lease qualifies as an operating lease under IFRS 16. In the consolidated financial statements, this intercompany lease has no impact as its impacts are completely eliminated.

With the lease, the application of IFRS 16 creates a difference in recognition method in the financial statements of the lessor and the lessee. The lessee recognises the lease as a so-called right-of-use asset and a lease liability on the balance sheet. The asset is depreciated on a straight-line basis and the lease liability is measured at amortised cost. As a result, the total cost of the lease shows a declining pattern over the term of the lease. In contrast, the lessor recognises the lease off-balance sheet and recognises the lease revenue on a straight-line basis over the lease term.

In A's company-only financial statements, these differences between the recognition for the lessor and lessee in accordance with the principles of DAS 260 can be eliminated in the carrying amount of participating interest B or as an accrual.

Example: Derivatives entered into by the parent entity (extracted from Appendix 1 to DAS 100)

Parent entity A uses a derivative to hedge a risk run by consolidated participating interest B. For the consolidated financial statements, hedge accounting requirements are met and applied as the hedged risk and the hedging instrument (derivative) are part of the same consolidation scope.

The hedged risk and the hedging instrument (derivative) are in different entities. Since in A's company-only financial statements, participating interest B is considered a mix of assets and liabilities, the underlying hedged risk is locked in the participating interest item. Hedge accounting is therefore also applied in the company-only financial statements.

Example: Financial instrument issued by a participating interest (extracted from Appendix 1 to DAS 100)

Consolidated participating interest B issues listed bonds worth 100 in year 1. 10% of the bonds are held by parent entity A and 90% of the bonds are held by third parties. In the consolidated financial statements, 10% of the bonds are eliminated and the remaining 90% are measured at amortised cost.

Participating interest B measures the bond loan (liability) at amortised cost of 100. A's share in this is 10 (= 10% of 100). If A's stand-alone position is determined under IFRS 9, A would, based on its business model or on the SPPI test, measure these bonds at fair value in its company-only financial statements. As at the reporting date, the fair value of the loan is 120, of which the parent entity holds 12 (= 10% of 120).

In A's company-only financial statements, the measurement difference on this intercompany relationship can be eliminated in accordance with the principles of DAS 260:

- in the carrying amount of the consolidated participating interest; or
- as an accrual.

For practical reasons, elimination is also allowed in A's company-only financial statements:

- in the carrying amount of the loan held

Transactions with non-consolidated participating interests
Transactions and/or balance sheet positions between the parent entity and its non-consolidated participating interests are recognised in the company-only financial statements in accordance with the recognition in the consolidated financial statements (DAS 100.112).

Possible differences between company-only and consolidated equity
The legislator's intention to make it possible to keep equity according to the company-only financial statements equal in principle to equity according to the consolidated financial statements does not mean that there cannot be differences between equity and profit or loss according to the company-only financial statements and the consolidated financial statements (DAS 100.109). As with combination 1 (see paragraph 1.2.1), differences may exist between equity according to the consolidated financial statements and equity according to the company-only financial statements in specific situations. Such differences are disclosed in the notes to the company-only financial statements (Article 2:389(10) NCC) (see paragraph 14.5.2). Examples of such differences are:

- transactions with a consolidated participating interest < 100%. If the interest in a consolidated participating interest is not 100%, differences may consequently arise between equity according to the company-only financial statements and equity according to the consolidated financial statements. This is because balance sheet positions and/or transactions are eliminated in full in the consolidated financial statements and proportionally in the company-only financial statements (DAS 100.110). See paragraph 15.2.2;
- a consolidated participating interest with negative equity. If a consolidated participating interest has negative equity, this may result in a difference between equity according to the company-only financial statements and equity according to the consolidated financial statements (DAS 100.111). See paragraph 9.2.6; and
- if the entity chooses to determine the distinction between equity and liabilities in the company-only financial statements on the basis of the legal form. In the consolidated financial statements, this distinction must be made on the basis of the economic reality of the contractual provisions. See paragraph 14.1.

Presentation
When applying the net asset value method, consolidated participating interests are presented in the company-only financial statements in accordance with (DAS 100.114):

- the net asset value method; or
- the equity method.

Under the net asset value method of presentation, goodwill is recognised separately on the balance sheet, while under the equity method of presentation, goodwill is recognised as part of the participating interests item. In both situations, reversal of impairment of goodwill is not permitted in accordance with the accounting principles as applied in the consolidated financial statements.

In both methods, the value at which these participating interests are recognised in the company-only financial statements is determined on the basis of the accounting principles applied in the consolidated financial statements. The presentation method has no bearing on this. Thus, the difference between the two options concerns only the presentation of goodwill. When measured at net asset value, goodwill is presented separately under intangible fixed assets. When the equity method is applied, goodwill is part of the participating interests item. By applying one of these variants, reconciliation can be maintained between equity in the company-only financial statements and equity in the consolidated financial statements.

This form of application of the equity method differs from the equity method as applied under IFRS (IAS 28) for the measurement of participating interests in which significant influence on business and financial policy is exercised ("associates"). We emphasise that under "combination 3", non-consolidated participating interests that qualify as associates or joint ventures are recognised, measured and presented in the company-only financial statements in accordance with the equity method as applied under IFRS. This is in line with the recognition of those non-consolidated participating interests in the consolidated financial statements under IFRS.

1.2.3.3 Presentation and disclosure requirements

The company-only financial statements under combination 3 are prepared on the basis of Title 9 Book 2 NCC. Thus, the presentation and disclosure requirements of Title 9 Book 2 NCC and the Decree on annual accounts format as well as the presentation and disclosure requirements of the Dutch Accounting Standards must be followed. As a result, the presentation and disclosure requirements of IFRS-EU are not followed in the company-only financial statements in this combination if they differ. For example, an interest that qualifies as a participating interest under Article 2:24c NCC is presented as a participating interest in the company-only financial statements, even if this interest is presented differently under IFRS-EU in the consolidated financial statements. Also (except in the case of public interest entities), Article 2:402 NCC applies, so that a condensed profit and loss account will suffice. See also the notes to combination 4 for the applicable provisions of Title 9 Book 2 NCC.

1.2.3.4 Exemptions based on size

Article 2:362(9) NCC indicates that if the financial statements are prepared in accordance with IFRS-EU, only a limited number of articles of Title 9 Book 2 NCC are applied, which are not deemed to include the exemptions based on the size of the entity (section 11 of Title 9 Book 2 NCC). However, if combination 3 is applied by a small entity, the company-only financial statements are prepared on the basis of Title 9 Book 2 NCC. This means that a small entity can indeed apply the exemptions based on the size of the entity, including the publication and audit exemptions. This also applies to a micro-sized entity applying combination 3. A medium-sized entity applying combination 3 can also apply the exemptions based on the size of the entity. However, medium-sized entities are not exempt from audit.

1.2.3.5 Other details

Additionally, with combination 3, there are further details that come into play in the recognition and measurement in the company-only financial statements. These are caused by the fact that the method of recognising some transactions as prescribed or allowed in IFRS-EU is not possible when applying Title 9 Book 2 NCC and the Dutch Accounting Standards. These include:

- the recognition of a step acquisition;
- the loss of control in an equity interest; and

- the acquisition or sale of part of an existing equity interest where control remains.

A number of Standards contain provisions for recognising such transactions in the company-only financial statements when applying combination 3. These provisions are explained below and all have in common the fact that these transactions are recognised in the consolidated financial statements in accordance with the recognition method prescribed under IFRS-EU. As a result, no differences between company-only and consolidated equity and profit or loss arise from the recognition of these transactions.

Step acquisition
In a step acquisition resulting in a business combination as defined in IFRS 3, an entity measures the existing interest at fair value at the acquisition date. The change in value of the existing interest as a result of this revaluation is recognised through the profit and loss account (DAS 214.312). Pursuant to Article 2:390(1) NCC, the entity recognises a revaluation reserve equal to the increase in value, unless frequent market quotations exist for the interest held (DAS 240.227c).

Loss of control
Loss of control occurs if the decisive influence in an equity interest is lost, while an equity interest is retained. In such a situation, an entity measures the remaining equity interest at the fair value at the time. The change in value of the remaining equity interest as a result of this revaluation is recognised in the profit and loss account (DAS 214.312a). Pursuant to Article 2:390(1) NCC, the entity recognises a revaluation reserve equal to the increase in value of the remaining interest held, unless frequent market quotations exist for the interest (DAS 240.227c).

Acquisition or sale of part of an existing equity interest while retaining control
If an entity buys or sells part of an existing equity interest, while retaining control, the difference resulting from this transaction between the transaction price and the carrying amount of the relevant part of the net assets is recognised directly in equity (DAS 214.312b).

1.2.4 Notes to combination 4

If an entity prepares both company-only and consolidated financial statements in accordance with IFRS-EU, the entity applies only the following of Title 9 Book 2 NCC and the Dutch Accounting Standards (Article 2:362(9) NCC):

- Article 362(6), the sentence before the last sentence, with requirements for notice if, after adoption, the financial statements are found to be seriously deficient;
- Article 362(7), last sentence, which stipulates that financial statement items must be described in the Dutch language unless the general meeting has resolved otherwise;
- Article 362(10) on the disclosure of which standards have been used to prepare the financial statements;
- Article 365(2) on the legal reserve for capitalised research and development costs;
- Article 373 on the presentation and disclosure of equity;
- Article 379(1) and (2) on information about equity interests of at least 20%;
- Article 380b part d on the declaration of the number under which the entity is registered in the Trade Register;
- Article 382 on the declaration of the average number of employees;
- Article 382a on the declaration of auditor's fees;
- Articles 383 and 383b to 383e on the declaration of remuneration for – as well as share or option ownership (in the case of open public limited liability entities) – and loans, advances and guarantees for the benefit of management board members and supervisory board members;
- Article 389(8) on the foreign currency translation reserve;
- Article 389(10), which requires disclosure in the notes to the company-only financial statements of the differences between equity and profit or loss according to the company-only financial statements and according to the consolidated financial statements;
- Article 390 on the revaluation reserve;
- section 7, Article 391, Management board report;
- section 8, Article 392, Other information;
- section 8A, Article 392a, Report on payments to governments;
- section 9 Audit; and
- section 10 Publication.

With combination 4, the peculiarity arises that there is a overlapping of the disclosure requirements of Article 2:383 NCC regarding the disclosure of the remuneration of management board members and supervisory board members, and those of IAS 24 regarding the disclosure of the remuneration of so-called "key management personnel". This is discussed in more detail at the end of paragraph 18.8.

A small entity cannot make use of the exemptions of Article 2:396 NCC (including the publication and audit exemptions) when applying IFRS-EU in its company-only financial statements. After all, section 11 of Title 9 Book 2 NCC does not apply either. To avoid these consequences of applying IFRS-EU in the company-only financial statements, applying combination 3 is a recommended alternative.

Obligation to consolidate in company-only financial statements under IFRS-EU
A peculiarity arises if an entity in the Netherlands voluntarily applies IFRS-EU in its company-only financial statements. In that case, in our view, it can be interpreted that section 13 of Title 9 Book 2 NCC is no longer the reference point for the question of whether there is a consolidation obligation, but rather IFRS-EU. The fact is, at that point, based on Article 2:362(9) NCC, the provisions of IFRS-EU (in this case IFRS 10) on consolidation have become law, and they replace the provisions of section 13. After all, the listing in Article 2:362(9) NCC of the articles of Title 9 Book 2 NCC to be applied in combination 4 is exhaustive due to the wording "only applies". The provisions of section 13 are then "set aside" by the entity itself. This means, for example, that under this interpretation, the entity cannot make use of the exemptions from the consolidation obligation contained therein (see paragraph 33.3).

However, there is also a view in the literature that the consolidation obligation (and exemptions from the consolidation obligation) are determined on the basis of national law, i.e. including in combination 4 based on section 13 of Title 9 Book 2 NCC (including the exemptions it contains) and not based on IFRS-EU. This view is based on a November 2003 EC report on the application of the IFRS Regulation. In this report, the EC indicates that provisions regarding the consolidation obligation do not change with the IFRS Regulation and remain based on EU Member State legislation. If this view is followed, IFRS 10's provisions on the consolidation obligation are effectively not part of the IFRS-EU regime.

As the latter view is supported in a fairly general sense in the accounting and reporting rules literature, we consider it acceptable. In a given case, this means, for example, that the company-only financial statements can be presented in accordance with IFRS-EU, while at the same time use can be made of the consolidation exemption for intermediate holding entities under Article 2:408 NCC. That exemption then replaces a similar (but not entirely analogous) exemption for intermediate holding entities included in IFRS 10 (paragraph 4).

1.2.5 Notes to combination 5

Article 2:362(1), second sentence NCC is rarely applied. According to this provision, if international presence so justifies, financial statements may be prepared according to the generally acceptable standards of another Member State of the EU. However, the condition is that the legally required insight (Article 2:362(1), first sentence NCC) be met.

In addition, the provisions of Title 9 Book 2 NCC also apply in full. Thus, the standards of another Member State can only be applied under the umbrella of Title 9 Book 2 NCC. Consequently, this is only possible to the extent that those standards are not inconsistent with Title 9 Book 2 NCC.

1.2.6 Capital protection when applying combinations

In Dutch capital protection law, creditors of entities are protected by rules intended to maintain the entity's capital to a certain extent. Only where *more* capital is present than this minimum may distributions (such as dividends or the purchase of own shares) be made to shareholders. For public limited liability entities, this is regulated in Article 2:105 NCC. The equity in this case must exceed the amount of the paid-up and called-up part of the capital plus the reserves that must be maintained by law or by the articles of association. Since the Act simplifying and flexibilising the law governing private limited liability entities (*Act simplifying and flexibilising the law governing private limited liability entities*), this capital requirement has been eased for private limited liability entities, but a private limited liability entity must still maintain at least equity equal to the reserves that must be maintained according to the law or the articles of association (Article 2:216 NCC). In addition, private limited liability entities are still subject to a resolution of approval by the management board before a profit distribution can be made. See paragraph 14.2. In this context, it is important to realise that the capital protection test pertains to the financial statements of the entity itself, i.e. the company-only financial statements.

The legal reserves mentioned in Articles 2:105 and 216 NCC have a number of sources which are summarised in Article 2:373(4) NCC. Some examples of legal reserves are the reserves for development costs (Article 2:365(2) NCC), the reserve for participating interests (Article 2:389(6) NCC), the foreign currency translation reserve (Article 2:389(8)) and the revaluation reserve (Article 2:390 NCC). See also paragraphs 14.3.7 and 14.3.8.

Regardless of the accounting policies applied (IFRS-EU or NL GAAP), Article 2:105 NCC (public limited liability entities) and Article 2:216 NCC (private limited liability entities), respectively, must be followed and therefore the legal reserves mentioned in Article 2:373(4) NCC must be taken into account. Thus, in principle, company-only financial statements under IFRS-EU have the same sources of legal reserves as financial statements under NL GAAP. Nevertheless, it should be realised that the company-only profit or loss and therefore the distributable equity may differ from one principle to another. This relates, for example, to the way equity interests are measured and other differences in measurement basis that may affect equity interests measured using the net asset value method.

1.3 IFRS-SME

1.3.1 Publication of IFRS-SME

A new set of international accounting rules, "IFRS for SMEs" ("IFRS-SME"), was published in 2009. Its author, the IASB, aims to provide a greatly simplified alternative to "full IFRS" ("IFRS"). As the target audience of IFRS-SME includes companies that are not publicly accountable, listed companies and financial institutions cannot apply these rules. For companies that are part of an international group, for example, applying IFRS-SME can be an attractive option. This has the benefit of internationally known rules, but not the high administrative burden of IFRS. In 2015, the IASB published amendments to IFRS-SME ("2015 Amendments to the IFRS for SMEs"). These amendments are applicable to financial years beginning on or after 1 January 2017, with earlier application permitted. These changes result from a comprehensive review by the IASB of the set of rules published in 2009. The content of paragraphs 1.3.2 and 1.3.3 is based on the version of IFRS-SME published in 2015.

1.3.2 Characteristics of IFRS-SME

Stand-alone set in addition to IFRS
IFRS-SME is a stand-alone set of accounting rules based on IFRS. However, IFRS-SME is separate from IFRS. There is therefore no obligation to fall back on IFRS if an issue is not covered by IFRS-SME. In that case, a company's management must decide on its own recognition method. In doing so, IFRS may be relied upon, but it is not mandatory. Only in respect of financial instruments is a reference to IFRS included, as a company can choose to apply IAS 39 for the recognition and measurement of financial instruments. As this is a stand-alone set of accounting rules, it also means that it is kept separate from the changes to IFRS.

Simplifications compared to IFRS
Compared to IFRS, IFRS-SME contains a number of simplifications. Examples of these simplifications are:

- some IFRS topics are not included because they are not relevant to the target audience;
- some recognition and measurement options from IFRS are not permitted, because a simpler option is available;
- simplification of some recognition and measurement options;
- substantially fewer disclosure requirements.

Topics not included in IFRS-SME
IFRS includes provisions for topics that apply exclusively or mostly to listed companies. IFRS-SME therefore does not include provisions on:

- earnings per share;
- interim reports;
- segment information; and
- assets held for sale.

Also, the provisions regarding insurance contracts are not included in IFRS-SME because insurance companies are not allowed to apply IFRS-SME.

Recognition and measurement options that are not permitted
IFRS-SME does not permit the following IFRS recognition and measurement options, because a simpler option is available:

- revaluation of intangible fixed assets;
- a choice between cost and fair value for an investment property. Under IFRS-SME, measurement at fair value is mandatory. Where the fair value cannot be determined with sufficient reliability or involves disproportionate cost or effort to determine, measurement is at cost;
- various options for recognition of government grants as included in IAS 20;
- capitalisation of borrowing costs;
- capitalisation of development costs.

For financial instruments, compared to IAS 39, the available-for-sale and held-to-maturity categories are not present. Also, the so-called tainting provisions and the fair value option do not exist. In addition, simplified provisions exist for hedge accounting and derecognition.

Simplification of recognition and measurement
IFRS-SME includes several simplifications for recognition and measurement compared to IFRS. Examples include:

- financial instruments that meet certain criteria are measured at amortised cost. All other financial instruments are measured at fair value through profit or loss;
- goodwill and other intangible fixed assets (including those with an infinite life) are amortised over their useful lives. If it cannot be reliably determined, the useful life is estimated based on management's best estimate, which may not exceed ten years;
- a simplified calculation is allowed for measurement of defined benefit plans when measurement using the projected unit credit method results in undue cost or effort;
- interests in associates and joint ventures may be measured at cost.

1.3.3 Can IFRS-SME be applied in the Netherlands?

The question is whether a Dutch company can apply IFRS-SME. Some inconsistencies with Title 9 Book 2 NCC could now prevent application in the Netherlands for some companies. Dutch law sets out the requirements for preparing financial statements. The law offers unlisted entities the option of voluntarily applying IFRS as approved by the EU (IFRS-EU), instead of the mandatory application of Title 9 Book 2 NCC ("Title 9"). If a company applies Title 9, the standards prepared by the Dutch Accounting Standards Board are also relevant. This is because the law requires a Dutch entity to prepare financial statements according to generally acceptable standards. The Dutch Accounting Standards are considered an acceptable standard in this context.

However, this does not preclude IFRS-SME from also being considered an acceptable standard. The provisions of IFRS-SME are derived from IFRS-EU. As they are based on the same accounting principles as IFRS-EU and the Dutch Accounting Standards, we regard this as an argument to conclude that IFRS-SME can also be considered an acceptable standard. The only condition is that application of IFRS-SME does not lead to inconsistencies with Dutch legal provisions, because the EU and the Dutch legislator do not (yet) explicitly allow IFRS-SME.

Application if international presence so justifies
If the international presence of its group so justifies, an entity may prepare financial statements according to the generally acceptable standards of another EU Member State and provide the required insight (Article 2:362(1) NCC). Application of IFRS-SME is therefore possible if the financial statements are prepared in accordance with the standards of another EU Member State under Article 2:362(1) NCC, and IFRS-SME is considered an acceptable standard in that other Member State. For example, in Ireland, unlisted companies apply a variant of IFRS-SME approved by the UK and Ireland through a provision in Financial Reporting Standard (FRS) 102.

Inconsistencies with Title 9 Book 2 NCC
IFRS-SME can only be applied under the umbrella of Title 9 Book 2 NCC ("Title 9"). Having analysed IFRS-SME, we find that a limited number of provisions within IFRS-SME may be inconsistent with Title 9. There are four possible

issues (see the table "Possible inconsistencies between IFRS-SME and Title 9"). The question is whether these issues prevent application of IFRS-SME. Companies that run into one or more of the aforementioned issues will have to determine whether that issue can be resolved within the limits of Title 9 and IFRS-SME. We expect it to be generally possible to comply with both Title 9 and IFRS-SME.

An entity that chooses to apply IFRS-SME under Title 9 will have to comply with the disclosure requirements of both Title 9 and IFRS-SME. The company will have to include the legally required disclosures in the financial statements, in addition to the disclosures required by IFRS-SME. Examples include the average number of employees, management board members' and supervisory board members' remuneration and possibly auditor's fees. Also, a Dutch entity will have to comply with the legal provisions related to capital protection, including the formation of legal reserves and the presentation and disclosure of equity.

Table: Possible inconsistencies between IFRS-SME and Title 9

	IFRS-SME	Title 9	Comment
Application of the equity method	Goodwill is part of the equity method of measuring the participating interest.	Goodwill is recognised as a separate item on the balance sheet and does not form part of the measurement of the participating interest.	We are of the opinion that a valid reason is present under Article 2:389(9) NCC for applying the equity method instead of net asset value.
Presentation of provisions	Provisions are in principle presented as part of non-current and/or current liabilities.	Provisions are presented between equity and debt.	The question is whether presentation of provisions in accordance with IFRS-SME is defensible under Title 9 and, in particular, the Decree on annual accounts format. We believe this is defensible as this method of presentation improves insight into the liquidity position. Also, IAS 1, which prescribes this method of presentation, has been approved by the European Union and is therefore not considered to be inconsistent with the core principle of European accounting and reporting rules (giving a "true and fair view"; translated in Title 9 as giving "the required insight").
Contingent liabilities in a business acquisition	In a business acquisition, a contingent liability should be recognised and measured at fair value.	Title 9 contains no specific provisions for recognition of contingent liabilities in a business acquisition.	We believe that contingent liabilities in a business acquisition can be recognised under Title 9 in accordance with the provisions of IFRS-SME.
Discontinued operations	Separate item in the profit and loss account for the profit or loss from discontinued operations.	No separate item in the profit and loss account for the profit or loss from discontinued operations.	With a double column in the profit and loss account, it is possible to comply with both Title 9 and IFRS-SME.

1.4 Deadlines

1.4.1 Deadline for preparing financial statements

The financial statements of a public limited liability entity and a private limited liability entity must be prepared annually by the management board within five months of the end of the financial year (Articles 2:101 and 210 NCC). For a cooperative, mutual guarantee association and commercial association or foundation, the deadline is six months (Articles 2:10, 48 and 58 NCC). The financial year of an entity coincides with the calendar year, i.e. 1 January to

31 December, unless the articles of association specify a different financial year, e.g. 1 September to 31 August (Article 2:10a NCC).

The five- or six-month period for preparing the financial statements can be extended by the general meeting (in the case of a public or private limited liability entity) or the members' meeting (in the case of a cooperative, mutual guarantee association or commercial association), due to special circumstances, by up to five months and four months respectively (Articles 2:48, 58, 101, 210 and 300 NCC). A general meeting or members' meeting should be formally convened to pass a resolution on extension and this decision-making process should be recorded in minutes. This then creates a maximum time limit for preparing financial statements of ten months after the end of the financial year.

1.4.2 Deadline for publishing financial statements

The prepared financial statements must be adopted by the general meeting. No legal deadline has been given for this. However, between the date on which the prepared financial statements are made available for inspection by shareholders and members and the date of actual adoption of the financial statements, there must be a period of at least several days (15 days for unlisted public limited liability entities (Article 2:115(1) NCC) and 8 days for private limited liability entities (Article 2:225 NCC)). The law also stipulates that once the financial statements have been adopted, they must be published within eight days by means of filing with the Trade Register (Article 2:394(1) NCC).

If the financial statements have not been adopted within two months after the expiry of the period prescribed for preparation – of five or six months or an extended period of up to ten months – the prepared financial statements (that have not yet been adopted) must be published (filed) without delay. Financial statements that have been published but not yet adopted ("provisional" financial statements) should explicitly state that they have not yet been adopted (Article 2:394(2) NCC). There is no need to state the reason why the financial statements have not yet been adopted. In any case, therefore, the financial statements must be published no later than 12 months after the end of the financial year (Article 2:394(3) NCC). Until the financial statements of a public limited liability entity are adopted, no dividend can be paid (Article 2:105 NCC). Any interim dividend paid, to the extent permitted by the articles of association and the law, may be considered an advance payment on the final dividend. Once a year, as part of (and after) the adoption of the financial statements, a formal decision will be taken as to whether the annual profits will be distributed or added to the reserves. Under the system of the law, any other distribution is an interim distribution, which will be deducted from freely distributable reserves in the unadopted financial statements.

1.5 Size criteria

The content of the legal obligation to prepare financial statements (presentation), as well as the content of the legal obligation to publish financial statements, depend primarily on the size of an entity. To this end, the law defines four categories, namely micro-sized, small, medium-sized and large entities. The larger the size of an entity, the more extensive the presentation requirements of the financial statements to be prepared and the more extensive the publication requirements of the financial statements to be published.

An entity is classified by size according to the following three size criteria (Articles 2:395a(1), 396(1) and 397(1) NCC):

- the value of assets (on the accounting principle of purchase or construction costs) according to the balance sheet with notes;
- net revenue for the financial year;
- the average number of employees for the financial year.

For the application of these criteria, the value of assets, net revenue and the number of employees of group entities that would have to be included in the consolidation if the entity had to prepare consolidated financial statements are taken into account. This does not apply if the entity applies the exemption of Article 2:408 NCC (paragraph 2 of Articles 2:395a, 396 and 397 NCC). If Article 2:408 NCC is applied, Article 2:389(9) NCC often allows the entity to measure its participating interests at cost instead of net asset value. To this end, see also Chapter 9. When applying the size criteria, this choice may affect the size of an entity.

The law does not give further provisions with regard to the average number of employees for the financial year, nor does the law contain rules for cases where a financial year is longer or shorter than 12 months. It is recommended that net revenue as a criterion for determining the applicable category be calculated proportionately over 12 months. In the case of a long financial year, it is also permissible to use the net revenue of the last 12 months as a criterion. It is recommended that the average number of employees be determined on the basis of man-years (FTEs) applied to the employees with whom the entity has entered into an employment contract within the meaning of Article 7:610 NCC (DAS 315.103). Since agency workers normally have an employment contract with the agency and not with the reporting entity, agency workers are not covered by this criterion. This also applies to hired self-employed workers under normal circumstances. See paragraph 18.2 for more details.

For the term "net revenue", see paragraph 26.8.

The general meeting may decide, no later than six months after the beginning of the financial year, not to apply the exemptions of micro-sized, small or medium-sized entities (Article 2:398(2) NCC).

An investment company or company for collective investment in securities to which Article 2:401(1) NCC applies and an entity designated as a public interest entity (see paragraph 1.1.1) may not use the exemptions for micro-sized, small and medium-sized entities (Article 2:398(3) and (7) NCC). Participation companies may not use the exemptions for micro-sized entities (Article 2:398(6) NCC).

Classification in another category (or change of category, e.g. from small to medium-sized) will only take place if the entity meets the criteria of the other category on two consecutive reporting dates.

For the first and second financial years, the classification into micro-sized, small, medium-sized or large is based on compliance with the relevant requirements as at the reporting date of the first financial year (Article 2:398(1) NCC).

A newly formed entity that qualifies as small at the end of the first financial year can also benefit from the exemptions for the small category in the second year. This applies even if this entity qualifies as medium-sized or large at the end of the second year.

The application of the size criteria can be illustrated by the following example:

	Meets criteria for:	Must meet obligations for:
Year 1	Micro-sized	Micro-sized
Year 2	Small	Micro-sized
Year 3	Medium-sized	Small
Year 4	Medium-sized	Medium-sized
Year 5	Large	Medium-sized
Year 6	Large	Large
Year 7	Medium-sized	Large
Year 8	Medium-sized	Medium-sized
Year 9	Small	Medium-sized
Year 10	Large	Medium-sized
Year 11	Large	Large

The size criteria are reflected in thresholds (amounts or numbers). The thresholds in European accounting and reporting rules, as set out in the EU Accounting Directive (2013/34/EU), can be indexed every five years.

For financial years that started on or after 1 January 2016, the following size criteria are included in Title 9 Book 2 NCC:

	Micro-sized entity	Small entity	Medium-sized entity	Large entity
Asset value	≤ €350,000	≤ €6,000,000	≤ €20,000,000	> €20,000,000
Net revenue	≤ €700,000	≤ €12,000,000	≤ €40,000,000	> €40,000,000
Number of employees	< 10	< 50	< 250	≥ 250

An entity is classified in a particular category (micro-sized, small, medium-sized or large) if at least two of the three criteria applicable to a category are met.

Adjustment of thresholds
The European Commission decided in October 2023 to increase the thresholds for the asset value and net revenue, as a result of which the following thresholds are now included in the EU Accounting Directive:

	Micro-sized entity	Small entity	Medium-sized entity	Large entity
Asset value	≤ € 450.000	≤ € 7.500.000*	≤ € 25.000.000	> € 25.000.000
Net revenue	≤ € 900.000	≤ € 15.000.000*	≤ € 50.000.000	> € 50.000.000
Number of employees	< 10	< 50	< 250	≥ 250

* This concerns the maximum thresholds allowed by Member States

EU Member States must apply the adjusted amounts at the latest for financial years starting on or after 1 January 2024. Member States have the possibility to apply the adjusted amounts already to the financial year starting on or after 1 January 2023. The amendments and their effective date have yet to be implemented in Title 9 of Book 2 NCC. At the time of closing the texts of this manual (31 December 2023), it is not yet known exactly how the adjusted amounts will be applied in the Netherlands. On 22 December 2023, the Council of Ministers adopted the draft Implementation Decree Directive adjustment size criteria, after which the draft Decree will be submitted to the Council of State for advice. The draft Decree includes a 25% increase in the thresholds. In the draft Decree the option is included to apply the increased thresholds for the financial year 2023.

Adjustment of comparative figures after change of category
The law does not explicitly comment on whether after changing category (e.g. from medium-sized to large) the comparative figures for the previous financial year should be adjusted to the different category in force at that time. Article 2:363(5) NCC, however, stipulates that for each item in the financial statements the amount from the previous financial year must be disclosed and, if necessary, revised for the sake of comparability. As a result, comparative figures have to be adjusted after changing categories.

Size criteria on the first and after the last application of the exemption for intermediate holding entities (Article 2:408 NCC) and after application of the group exemption (Article 2:403 NCC)
If an entity applies the exemption for intermediate holding entities under Article 2:408 NCC (see paragraph 33.3.2), it determines the size based on its company-only figures (paragraph 2 of Articles 2:395a, 396 and 397 NCC). The question now is how a long-established entity should apply the size criteria in the first financial year it benefits from the exemption of Article 2:408 NCC. This issue is particularly relevant if an entity qualifies as "small" or "micro-sized" on the basis of its company-only figures, but as "large" or "medium-sized" on the basis of its consolidated figures.

In our opinion, when Article 2:408 NCC is applied for the first time in any financial year, the size will have to be determined on the basis of the company-only figures of both the current financial year and the previous financial year. After all, the entity applies Article 2:408 NCC and therefore determines its size on the basis of the company-only figures. This means that the entity – which qualifies as "small" or "micro-sized" on the basis of its company-only figures, but as "large" or "medium-sized" on the basis of its consolidated figures – qualifies as "small" or "micro-sized" immediately from the first year of application of Article 2:408 NCC.

Vice versa, this position means that an entity *no longer* benefiting from the exemption of Article 2:408 NCC for the first time in the financial year must apply the size criteria based on its consolidated figures. The entity – which qualifies as "small" or "micro-sized" on the basis of its company-only figures, but as "large" or "medium-sized" on the basis of its consolidated figures – then falls under the "large" or "medium-sized" regime immediately from the first year it prepares consolidated financial statements. This is similar to a newly formed company that has to determine the applicable regime under Article 2:398(1) NCC based on the size criteria for the first financial year.

A similar situation arises for first-time application of the group exemption of Article 2:403 NCC. An entity that goes back to preparing financial statements in accordance with Title 9 Book 2 NCC for the first time, having had the group exemption from Article 2:403 NCC apply to the previous financial years (see paragraph 1.7), determines the applicable size regime on the basis of the figures for that first financial year only.

In our view, this position best represents the insight that financial statements should provide their users. With the removal of the exemption for intermediate holding entities as well as the removal of the group exemption of Article 2:403 NCC, the user will benefit from the insight to be provided under the then applicable regime. After removal, the entity again finds itself in the same situation as an entity that has not used one of the exemptions in the interim. Furthermore, it is clear from the legislative history that the legislator's main aim with the two-year regime was to ensure that companies that are on the borderline of regime change in terms of activity level do not have to change regime every year. In the transition from small to medium-sized, another factor is that auditing will become mandatory. A company that classifies as medium-sized for the first time can look for an auditor in time if it expects to also achieve the medium-sized criteria in the second financial year.

Article 2:363(5) NCC stipulates that for each item in the financial statements the amount from the previous financial year must be disclosed and, if necessary, revised for the sake of comparability. As a result, in the first financial statements after applying the exemption for intermediate holding entities (Article 2:408 NCC) or after application of the group exemption scheme (Article 2:403 NCC), the comparative figures must be disclosed.

Size criteria on incorporation and in the event of contribution or acquisition of activities
As indicated above, a newly formed or incorporated entity will have to determine the applicable regime under Article 2:398(1) NCC based on the size criteria for the first financial year. The question is whether these rules also apply if activities are brought into a long-standing shell or shelf company. This occurs in transactions under common control, as well as in external acquisitions where the acquired business is brought into a designated acquisition vehicle. The shell entity will be classified as "micro-sized" or "small" in the previous financial year. Application of the two-year regime means that even in the year of contribution or acquisition, the entity will be classified as "micro-sized" or "small". In our view, partly in the light of the legislative history of the introduction of the Fourth EC Directive, a substantive law interpretation should take place in this case. The Minister indicated in Explanatory Memorandum that the two-year regime serves to prevent an overly frequent change of size regime. More or less random outliers in a given year could otherwise affect the regime. Contribution of activities to a shelf company can essentially be equated with the formation or incorporation of an entity and therefore, in our opinion, the applicable regime should be determined on the basis of the size criteria for the financial year in which the contribution or acquisition takes place. It then essentially makes no difference whether an entity is formed or incorporated or is taken "off the shelf".

Of course, the two-year period does apply in the case of a merger or acquisition by an existing entity. After all, in that case there is an aggregation of already existing separate companies (see paragraph 31.1).

Size criteria in first financial statements after transition from IFRS-EU to NL GAAP and after transition from NL GAAP to IFRS-EU
An entity that applies IFRS-EU in its company-only financial statements cannot make use of the exemptions of Articles 2:395a, 396 and 397 NCC. This also applies in the first year of application of IFRS-EU.

If an entity no longer applies IFRS-EU, but prepares company-only financial statements in accordance with the provisions of Title 9 Book 2 NCC plus the Dutch Accounting Standards (NL GAAP), the provisions of Articles 2:395a, 396 and 397 NCC apply once again. The question now is how an entity should apply the size criteria in the first financial year in which it can again benefit from the provisions of Articles 2:395a, 396 and 397 NCC.

Again, and based on the same arguments as in the section on group and intermediate holding entity exemptions, our view is that in the first financial year after the transition from IFRS-EU to NL GAAP, the size should be determined based on the figures from both the current financial year and the previous financial year. If the entity qualifies as small on this basis, this regime will apply immediately in the first financial year of application of Title 9 Book 2 NCC. The applicable regime in this case is not affected by the application of IFRS-EU in previous years.

1.6 Requirement to publish the annual report and accounts

1.6.1 Method of publishing the annual accounts

Dutch entities must disclose or publish adopted annual accounts by filing them with the Trade Register at the office of the Chamber of Commerce. The published (filed) financial statements must state the day (date) of adoption (Article 2:394(1) NCC).

Disclosure or publication will in principle take place by filing the financial statements, the management board report and Other information with the Trade Register. As a result of the implementation of the amended First EC Directive, the Trade Register Act, the Decree on the Trade Register and the Decree on annual accounts format were amended in 2005. This opens up the possibility of electronic filing of financial statements and other documents. In late 2015, the

Trade Register Act was amended in connection with the obligation to file documents in the Trade Register electronically. This obligation to file documents via Standard Business Reporting (SBR) will be phased in through an order in council (Decree on electronic filing Trade Register; *Besluit elektronische deponering Handelsregister*). Under this Decree, financial statements of medium-sized entities, small entities and micro-sized entities must be filed electronically via SBR. Small entities and micro-sized entities can also use the online service of the Chamber of Commerce as an alternative to SBR.

For large entities, the Decree does not include an obligation to file documents electronically via SBR for the time being. A draft amendment to the Decree was published on 11 May 2022 for the purpose of an internet consultation. The amendment proposes that large entities and associated medium-sized entities will also have to file documents electronically via SBR from financial year 2023. The amendment to the Decree has not yet entered into force. According to the website of the Chamber of Commerce, large entities are expected to be required to file digitally from financial year 2025.

Certain entities are exempt (for the time being) from the obligation to file via SBR in the Decree on electronic filing Trade Register. These include:

- medium-sized group entities, if the head of the group is an issuer or a large company. Electronic filing by these entities will be regulated simultaneously with the supplement to the Decree aimed at large entities (see previous paragraph);
- non-Dutch entities and companies as listed in paragraph 4.3.4 of the Decree on the Trade Register 2008.

An entity may choose not to file the management board report and part of the Other information with the Trade Register. This concerns (1) rules in and rights under the articles of association and (2) declaration of the number of non-voting and non-participating or restricted participating shares. The entity should then make these documents available for inspection to everyone at its offices and provide a copy of them at no more than cost upon request. This method of disclosing the management board report and part of the Other information must be declared to the Trade Register (Article 2:394(4) NCC).

As indicated in paragraph 1.1.8, the published copy of the financial statements should be in the Dutch language or, if not produced, in French, German or English. At the same time, a copy of the management board report and the Other information in the same language, or in Dutch, must be published. The signing of financial statements by the management board members and supervisory board members applies to the prepared financial statements ("the original copy of the financial statements") and not to the financial statements that are published. Unless the original copy of the financial statements is published (filed) with the Trade Register, a mention on publication of the names of the signatories will suffice (because the original signatures are on the original copy). If a signature is missing on the original copy, the reason will also be stated on the other copies. See also paragraph 1.1.5.

1.6.2 Content of the publication requirement

The content of the annual accounts to be disclosed (published) by the entity depends on the category in which an entity is classified. In broad terms, the publication requirement is as follows:

Large entity	
Financial statements	Full
Management board report	Full*
Other information	Full*

Medium-sized entity	
Financial statements	
- balance sheet with notes	Somewhat limited
- profit and loss account with notes	Somewhat limited
- other notes and accounting principles	Almost full
Management board report	Almost full*
Other information	Almost full*

Small entity	
Financial statements	
- balance sheet with notes	Very limited
- profit and loss account with notes	None
- accounting principles	Full
- other disclosures:	
- in respect of balance sheet	Almost full
- in respect of profit and loss account	None
Management board report	None
Other information	None
Micro-sized entity	
Financial statements	
- balance sheet	Very limited
- profit and loss account	None
- notes	None
Management board report	None
Other information	None

* The management board report and some of the Other information (items 2, 3, 4 and 6 mentioned in paragraph 1.1.6.4) do not have to be filed (published) with the Trade Register. It may also be chosen to keep them at the entity's offices for inspection. However, full or partial copies must then be provided on request at no more than cost. This must be recorded in the Trade Register (Article 2:394(4) NCC).

Publication exemptions for medium-sized and small entities are contained in Articles 2:397 and 396 NCC, respectively. In addition to the legal exemptions from the presentation and publication requirements, medium-sized entities are also subject to exemptions from certain accounting standards. Annexes 1 and 2 of DAS 315 contain overviews of the legal exemptions and exemptions from the standards for medium-sized entities, respectively. DASsmall D4 "Presentation and publication requirements for small entities" contains a similar annex for small entities. A particular issue arises if a medium-sized entity provides voluntary information (i.e. not required under Title 9 Book 2 NCC or under the Dutch Accounting Standards) in the internal financial statements. Should such information then also be included in the financial statements to be published? The Dutch Accounting Standards Board does not answer this question. DAS 315.201 and DASsmall A6.102 refer only to the relevant legal provisions. Our interpretation of DAS 315.201 is that a medium-sized entity that voluntarily includes information in its internal financial statements may, but need not, publish it. For small entities, our interpretation of DASsmall A6.102 is that a small entity does not need to publish information "over and above the legal minimum" (i.e. that is not required by Title 9 Book 2 NCC), but only that information that is expressly required by Title 9 Book 2 NCC and therefore Article 2:396 NCC in particular. An important note here is that the published financial statements for medium-sized and small entities are also subject to the insight requirement as formulated in Article 2:362(1) NCC. In addition, paragraph 4 of this article states that if the insight requires it, the entity must include information in the financial statements *in addition to* the other requirements of Title 9 Book 2 NCC (Article 2:362(4) NCC). In other words, information provided additionally under the insight requirement should also be included in the published financial statements.

1.6.3 Publication requirement for micro-sized and small entities

A micro-sized entity need only publish a highly condensed balance sheet without notes (Article 2:395a NCC). The Dutch Accounting Standards Board has indicated that if a micro-sized entity voluntarily includes more information in the prepared financial statements than required by Article 2:395a NCC, it may nevertheless publish the balance sheet in accordance with Article 2:395a(8) NCC (DASsmall M1.402). See Chapter 39.

A small entity is only required under the law to publish a highly condensed balance sheet with notes and is not required to publish the profit and loss account, management board report and Other information. Moreover, unlike the financial statements of medium-sized and large entities, the financial statements of micro-sized and small entities are legally exempt from audit.

Concurrence with the group exemption (Article 2:403 NCC)
A so-called 403 statement may have been issued by the head of the group or an intermediate holding entity of a small group for the benefit of one or more group entities. In addition, if other conditions are also met, that group entity does not have to prepare and publish financial statements. This exemption is discussed in detail in paragraph 1.7. Another condition is that the financial data of that group entity are included in the consolidated financial

statements of the entity that issued the 403 statement. This means that that entity cannot then use the consolidation exemption for small groups of Article 2:407(2) NCC. It is not clear from the legislative history whether those full consolidated financial statements (balance sheet and profit and loss account with notes) must also be published.

Small non-profit entities
For a small entity that does not seek to make a profit, the law contains the possibility of full exemption from publication of the financial statements (Article 2:396(9) NCC). Probably the most famous example of this is a small private pension company. The legislative history shows that "for example, private limited liability entities that are more an extension of the shareholder in their private, non-professional or non-business activities" are also described as "entity of a private nature without profit motive". The no-profit condition does not mean that no return can be sought in managing and investing assets. For instance, in the case of a private pension company, the return on the invested pension assets will not be distributed as profit. In contrast, the return on the invested assets of a private investment company does lead to distributable profits. Activities related to the value preservation of equity should be paramount, to benefit from this exemption. For activities aimed at building (and distributing) equity, this exemption from the publication of the annual report and accounts does not apply.

To be able to make use of this exemption, the following requirements must be met (Article 2:396(9) NCC).

- the small entity does not seek to make a profit; and
- the annual accounts, i.e. the annual accounts that every other small entity is required to publish, must be available for inspection at the offices of this small entity or will be sent free of charge to all creditors, shareholders or holders of share certificates upon request; and
- a statement from an auditor in public practice is filed with the Trade Register, certifying that the entity did not carry out any activities during the financial year other than mentioned in the objects clause and that this publication exemption applies to the entity.

This publication exemption is therefore counterbalanced by "the right of creditors, shareholders and holders of share certificates to obtain copies of or inspect the annual accounts" as well as "a statement from an auditor in public practice that the entity is small and has no activities other than according to its objects set out in the articles of association". The legislative history shows that preventing misuse of this publication exemption is the reason for this statement from an auditor: "Audit is not required for small companies, but this is the only sufficient dam against misuse" (Explanatory Memorandum House of Representatives 20 556 no. 3). In our view, what matters first and foremost is the actual objective of the entity rather than its objects set out in the articles of association. After all, it will almost never be literally deducible from the objects set out in the articles of association of a private limited liability entity, for example, whether or not there is an intention to make a profit. In our opinion, if it can be deduced from actual activities, or the absence of such activities, that the private limited liability entity has refrained from profit-making activities, the exemption from the publication requirement can be made use of. Conversely, actual activities may take place with a profit motive, even though the articles of association state that the company does not intend to make a profit. In our opinion, use cannot be made of the exemption in such a situation.

Micro-sized non-profit entities
Micro-sized entities can also avail themselves of this full exemption from publication of financial statements. Article 2:396 NCC applies "without prejudice to Article 395a" (Article 2:396(1) NCC). This means that a micro-sized entity – in addition to the exemptions for micro-sized entities contained in Article 2:395a NCC – can also make use of the exemptions for small entities contained in Article 2:396 NCC. Of course, the aforementioned requirements for applying that option must then be met.

1.7 Group exemption (Article 2:403 NCC)

1.7.1 Consolidated financial statements and group exemption

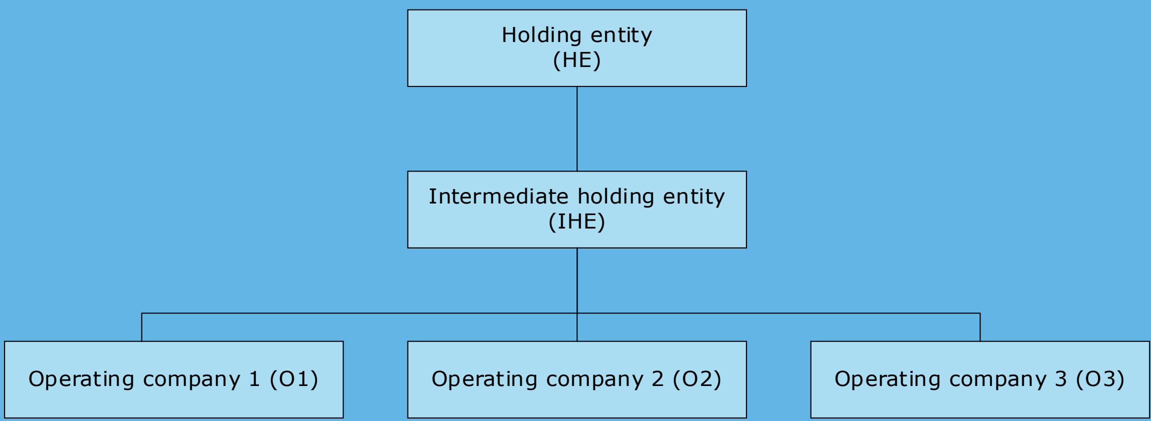
The entity that is – alone or together with another group entity – at the head of its group (or part of the group) has to prepare consolidated financial statements in addition to company-only financial statements (Article 2:406 NCC). The NCC defines a group as an economic unit in which entities and companies have an organisational association. Group entities are entities and companies associated with each other in a group (Article 2:24b NCC). The answer to whether there is a group and, if so, which entity heads it, is detailed in the Dutch Accounting Standards. These state that a group relationship exists if the parent entity substantially controls or has actual power to determine policy in the other dependent entity or entities (DAS 217.202). Small entities and micro-sized entities can make use of an exemption from consolidation (Article 2:407(2) NCC). Intermediate holding companies can omit consolidation if use is made of the exemption contained in Article 2:408(1) NCC. Chapter 33 discusses consolidated financial statements and consolidation exemptions in more detail.

In practice, the situation may arise where the head of the group has issued a liability statement in respect of one or more of its group entities. If the conditions of Article 2:403 NCC are met, the group entity for which a liability statement has been issued does not actually have to comply with the requirements of Title 9 Book 2 NCC. This legal option is known as the group exemption.

One of the conditions of Article 2:403 NCC is that the financial data of the group entity for which the liability statement has been issued are included in the consolidated financial statements of the entity that issued the liability statement. Another important condition is that these consolidated financial statements fall under the law of the EU Accounting Directive (Directive 2013/34/EU) or the IFRS Regulation. Use of Article 2:403 NCC implies that the entity or company that issued the liability statement cannot make use of the two consolidation exemptions mentioned above (small group exemption and intermediate holding entity exemption). If one of these exemptions is applied, the conditions of Article 2:403 NCC are no longer met, as the entity that issued the liability statement has to prepare consolidated financial statements containing the data of the companies to which the liability statement was issued.

Example: Group exemption

A group consists of five companies: a holding entity (HE), an intermediate holding entity (IHE) and three operating companies (O1 to O3). A 100% shareholder relationship exists between all the companies. IHE does not wish to prepare consolidated financial statements itself, but instead wishes to use the consolidation exemption for intermediate holding entities (Article 2:408 NCC). O1 does not wish to publish financial statements, but instead wishes to make use of the group exemption (Article 2:403 NCC).



O1 can only benefit from the group exemption if the company that includes O1's data in its consolidation has issued a liability statement and falls under the law of the EU Accounting Directive (Directive 2013/34/EU) or the IFRS Regulation. Since IHE wishes to make use of the consolidation exemption for intermediate holding entities, IHE cannot issue the liability statement for O1. This liability statement will then have to be issued by HE.

However, if HE is not subject to the law of the EU Accounting Directive (Directive 2013/34/EU) or the IFRS Regulation, under Article 2:403 NCC, the exemptions for O1 do not apply. If O1 still wants to benefit from these exemptions then IHE will have to issue the liability statement. However, this then implies that IHE has to prepare consolidated financial statements and therefore cannot benefit from the consolidation exemption.

Brexit and application of the group exemption
The United Kingdom of Great Britain and Northern Ireland (UK) ceased to be an EU Member State on 1 January 2021. Therefore, for financial statements prepared on or after 1 January 2021, it will no longer be possible to apply the group exemption on the basis of the consolidated financial statements of a UK-based entity.

1.7.2 Further conditions and content of the group exemption

The group exemption means that the group entity can prepare the financial statements in a simplified manner, does not have to publish these financial statements, does not have to have them audited by an auditor and does not have to prepare or add a management board report and Other information. However, in order to benefit from this group exemption, all the following conditions must be met:

1. the group entity must prepare financial statements (not for publication); these financial statements need not be prepared in accordance with the requirements of Title 9 Book 2 NCC. In all cases, the balance sheet should disclose the sum of fixed assets, the sum of current assets, and the amount of equity, provisions and debt. In each instance, the profit and loss account will disclose the profit or loss from ordinary business operations and the balance of other income and expenses, after tax (Article 2:403(1)(a) NCC). Incidentally, these summary financial statements do need to be adopted by the general meeting, as the articles of law governing adoption are not rendered inoperative by Article 2:403 NCC;
2. after the start of the financial year but before the financial statements are adopted, a written statement of consent from all members or shareholders, in which such members or shareholders agree to the use of this group exemption, must be filed with the Trade Register (Article 2:403(1)(b) and (g) NCC);
3. the financial data of the group entity have been consolidated by another entity or company (parent entity) in consolidated financial statements to which, under applicable law, the EU Accounting Directive (Directive 2013/34/EU) or the IFRS Regulation (or one of the EC directives for banks/financial institutions or insurance companies) applies (Article 2:403(1)(c) NCC);
4. these consolidated financial statements are drawn up in, or translated into, Dutch, French, German or English and must be filed with the Trade Register (Article 2:403(1)(d) and (g) NCC);
5. the auditor's report and the management board report are drawn up in, or translated into, the same language as the consolidated financial statements and must also be filed with the Trade Register (Article 2:403(1)(e) and (g) NCC); and
6. the consolidating entity or company must file a written statement with the Trade Register, declaring that it is jointly and severally liable for debt arising from legal acts of the group entity (Article 2:403(1)(f) NCC).

An entity classified as a public interest entity (see paragraph 1.1.1) cannot benefit from the group exemption.

The statement of consent mentioned above under 2 must be filed annually with the Trade Register.

The consolidated financial statements, auditor's report and management board report referred to under 4 and 5 must also be filed with the Trade Register, in each case within six months of the reporting date or within one month of an authorised later publication, or reference must be made to the office of the Trade Register where they have been deposited. This relates to the authorised later publication of consolidated financial statements. For example, the consolidating entity may have obtained a deferral for the preparation of its financial statements under legal provisions. There may also be a consolidating entity that is based in a country that applies a longer period for publishing financial statements. If, on this basis, the consolidating entity is not required to publish its consolidated financial statements within six months of the reporting date, the filing deadline under the group exemption is also extended.

The liability statement referred to under 6 is filed once with the Trade Register (Article 2:403(1)(g) NCC). There is no explicit provision in the law about the deadline by which this statement must be filed to still benefit from the group exemption. The literature (including *Compendium voor de jaarrekening*) takes the position that the statement must be filed before the adoption of the group entity's financial statements, but at the latest within 12 months after the end of the group entity's financial year (if the group entity's financial statements have not yet been adopted).

An entity or company that has issued the liability statement cannot benefit from the small group consolidation exemption of Article 2:407(2) NCC. The concurrence of the publication requirement of a small entity with the group exemption is described in paragraph 1.7.1.

If, in the group or part of the group whose data are included in the consolidated financial statements, the consolidating entity is at the same level of another entity/sister entity, this entity/sister entity also needs to have made a statement of assumption of liability. A group entity using the group exemption does not need to attach a management board report and Other information to its condensed annual accounts (under the former condition). Moreover, there is no legal duty to audit and no need to publish (Article 2:403(3) NCC).

Change of ownership during the financial year
A condition for making use of the group exemption of Article 2:403 NCC is that the financial data of the entity are included in the consolidated financial statements of a larger entity. In the case of an acquisition during the year, the buyer will consolidate the newly acquired group entity only from the acquisition date. The question is then whether the entity can benefit from the group exemption of Article 2:403 NCC in the year of acquisition. We believe this is possible.

Example: Acquisition during the year

On 1 September, B BV acquires all the shares in the capital of A BV. B should consolidate A from the acquisition date of 1 September. If possible, A wants to apply the group exemption of Article 2:403 NCC with effect from the year of acquisition. The interpretation of "the financial data of the entity" is important here (Article 2:403(1)(c) NCC). In our opinion, this relates to those financial data that must be included in the consolidated financial statements of the larger entity according to the applicable accounting standards (NL GAAP, IFRS-EU). Since A's financial data (the acquisition balance sheet as at 1 September, the balance sheet as at 31 December and the profit and loss account for the last four months of the year of acquisition) are included in B's consolidated financial statements, A can make use of the group exemption of Article 2:403 NCC.

IFRS-EU and application of Article 2:403 NCC
The parent entity of a Dutch unlisted subsidiary applies IFRS-EU in its consolidated financial statements. The question is whether this subsidiary can make use of the exemption in Article 2:403 NCC. The Dutch Accounting Standards Board states that this is possible as long as the other conditions of Article 2:403 NCC are met (DAS 305.201a). Another question is whether the subsidiary can prepare 403 financial statements using the figures from the consolidation statement under IFRS-EU. The Dutch Accounting Standards Board concludes that this is possible (DAS 305.203).

1.7.3 Risks of making use of the group exemption

At first sight, if the parent entity publishes consolidated financial statements, it seems very practical and obvious to file a 403 statement. This is because the relevant group entity would not then have to publish financial statements independently. Yet it is also known, including from case law, that the use of the group exemption can lead to unnecessary risks. Indeed, it may be risky for the parent entity to make itself fully liable for all debt arising from legal acts entered into by another entity (the relevant group entity).

The following are brief examples of situations where things can go wrong because liability arises (or continues to exist), but use cannot be made of the group exemption of Article 2:403 NCC:

a. a 403 statement is issued by an incorrectly consolidating parent entity;
b. a 403 statement is issued by the wrong (parent) entity;
c. no statement of consent has been filed;
d. forgot to withdraw the 403 statement;
e. a 403 statement has been issued, but it is not compliant.

Re a. a 403 statement is issued by an incorrectly consolidating parent entity
The figures of the group entity must be consolidated (by the parent entity) in financial statements to which, under applicable law, the EU Accounting Directive (Directive 2013/34/EU) or the IFRS Regulation (or one of the EC directives for banks/financial institutions or insurance companies) applies. To use the 403 statement, the consolidating parent entity that assumes liability must therefore be an entity incorporated under the law of one of the EU Member States.

An exception to this is an entity incorporated under the law of a non-EU Member State and actually established in an EU country that applies the doctrine of "real seat" as a starting point (e.g. Belgium, Germany). This doctrine means that the law of the country in which the entity or its management board is established applies to that entity. Such an entity may also qualify as a consolidating parent entity for the purposes of the group regime.

Re b. a 403 statement is issued by the wrong (parent) entity
In groups of entities, there is often a top holding entity with one or more intermediate holding entities below it. In that situation it seems logical to have the intermediate holding entity, which is the head of part of the group, issue the 403 statement(s) for the benefit of the group entities within that part of the group. However, it is then necessary for that intermediate holding entity to include the figures of this group entity or these group entities in consolidated financial statements.

If the intermediate holding entity issues a 403 statement but does not consolidate the figures of the relevant group entity, for example because it is making use of the consolidation exemption for intermediate holding entities (Article 2:408 NCC), this does not meet the conditions for the group exemption and the group entity is wrong to apply Article 2:403 NCC.

Re c. no statement of consent has been filed
The statement of consent must be filed with the Trade Register annually, or at least every year that one wishes to make use of the group exemption (Article 2:403(2) NCC). All shareholders must declare their consent in writing. If a shareholder refuses to give a statement of consent, use cannot be made of the group exemption.

Re d. forgot to withdraw the 403 statement
If a company is no longer part of the group or if its figures are not or are no longer included in the consolidated financial statements, a 403 statement no longer serves a purpose and it is advisable to withdraw it. If withdrawal is overlooked, there can be unpleasant consequences. A creditor of a former group entity that has a claim against said entity arising from a legal act can recover this claim from the former parent entity, referring to the 403 statement at the Chamber of Commerce.

Re e. a 403 statement has been issued, but it is not compliant
If a liability statement contains a time limitation (a temporal limitation), one of the conditions of the group exemption is not met, for example if the statement declares that it is valid "for legal acts entered into from today". According to case law, this is contrary to Article 2:403(1)(f) NCC, which talks about "for debt arising from legal acts of the entity". Since Article 57 of the Fourth EC Directive, on which Article 2:403 NCC is based, refers to "commitments entered into", this is a strong indication that this article should be interpreted such that obligations existing at the time of making and filing the 403 statement also come within the scope of the liability statement. A limitation in the liability statement to the obligations entered into "from today" is contrary to this.

1.7.4 Withdrawal of a liability statement

If a parent entity has withdrawn the 403 statement, liability continues to exist for debt arising from legal acts performed possibly even after such withdrawal but before the withdrawal can be invoked against the creditor. Thus, this withdrawal has no retroactive effect. The withdrawal only has retroactive effect if the conditions of Article 2:404(3) NCC are met. The creditor can file an opposition to the intention to terminate joint and several liability with the court up to two months after the announcement (Article 2:404(5) NCC). The ruling can be appealed to the Enterprise Division.

Upon withdrawal of an issued statement of assumption of liability (whether retroactive or not), all conditions of Article 2:403(1) NCC are no longer met. Therefore, from then on, the obligations regarding the presentation, audit and publication of the financial statements revive. This means that financial statements for the financial year in which the liability statement is withdrawn must be presented, audited and published in accordance with the provisions of Title 9 Book 2 NCC. After all, creditors can now no longer rely on the parent entity's liability statement, and now have an interest in receiving the same information as in the situation where no liability statement was issued in the past. This means that comparative figures must also be included for the previous financial year, even if that year was covered by the Article 403 group exemption. Moreover, if the annual accounts for the year prior to the withdrawal of the liability statement have not yet been adopted, in our opinion, financial statements for that year must also be presented, audited and published in accordance with the provisions of Title 9 Book 2 NCC.

Example: Withdrawal of a liability statement

A subsidiary has a financial year ending on 31 December. The liability statement issued by the parent entity is withdrawn on 15 July of year 2. The subsidiary must prepare, have audited and publish financial statements for year 2 in accordance with the provisions of Title 9 Book 2 NCC. If by 15 July of year 2, the subsidiary's annual accounts for year 1 have not yet been adopted, the subsidiary must also prepare, have audited and publish financial statements for that year in accordance with the provisions of Title 9 Book 2 NCC.

If, by 15 July of year 2, the subsidiary's annual accounts for year 1 have been adopted, it is sufficient for the subsidiary to publish the parent entity's consolidated financial statements for year 1.

1.8 Reporting payments to governments

According to the Decree on the Reporting payments to governments and Article 2:391a NCC certain entities must publish reports of payments to governments. The Dutch Accounting Standards Board addresses the scope and some elements of this report in DAS 500 "Country information – reporting of payments to governments ('country-by-country reporting')".

Purpose and scope

The obligation to prepare and publish this report applies to (Article 2 of the Decree on reporting payments to governments):

- a large entity (an entity which, on two consecutive reporting dates, without interruption thereafter on two consecutive reporting dates, has not met at least two of the requirements referred to in Article 2:397(1) and (2) NCC);
- a public interest entity (an entity as referred to in Article 2:398(7) NCC) (see paragraph 1.1.1); and
- an issuer (as referred to in Article 5:25e of the Financial Supervision Act);

operating in the extractive industry or logging primary forests.

This report is a separate report prepared and published alongside the financial statements, the management board report and the Other information. The report does not have to be adopted by the general meeting and it does not have to be audited by an external auditor.

The Explanatory Memorandum to the Decree states the following about this report: "Annual reporting on payments to governments ('country-by-country reporting') by companies in the extractive industry and in the logging of primary forests is, to a large extent, aimed at understanding the payments made to governments in exchange for the extraction of said raw materials in the respective countries. This reporting reminds governments of their responsibility for resource use in their countries. In several countries, revenues from such resource exploitation make up a substantial part of their State revenues. When it comes to developing countries, revenues do not always benefit citizens and build the State and economy. Citizens and civil society organisations will gain a better understanding of government revenues, not only nationally, but also regionally and locally, thanks to structural reporting. This way, they can put pressure on governments of resource-rich countries to be open about the use of raw materials and the spending of the resulting government revenues. This can help reduce corruption and bribery and encourage good governance and political stability and thus improve the investment climate in the countries concerned."

This report does not apply to the entity whose payments made to governments are included in a consolidated report on payments to governments prepared in accordance with Article 5 of the Decree or in accordance with the law of a Member State (Article 3(2) of the Decree on reporting payments to governments).

Legal entities that prepare and disclose a report that complies with the reporting requirements of a third country that, pursuant to Article 47 of the EU Accounting Directive (2013/34/EU), have been assessed as equivalent to the requirements of Chapter 10 of that Directive, are exempt from the requirements of the Decree, except for the obligation to disclose that report as referred to in Article 2:392a(2) NCC and Article 5:25e of the Financial Supervision Act (article 6 of the Decree on reporting payments to governments).

The Explanatory Memorandum to the Decree states in this regard: "Article 6 contains a provision for when third-country reporting requirements are declared by the European Commission to be equivalent to the provisions of Chapter 10 of the Accounting Directive under Article 46 of the Accounting Directive. See also paragraph 5 of the general part of these notes on this equivalence statement. A company that has an obligation to prepare a report in the Netherlands, but also already prepares such a report in accordance with the rules of a non-EU Member State whose reporting requirements have been declared equivalent to those of the EU by the European Commission, does not have to prepare a second report in accordance with the EU rules and the Decree. Filing the report with the Trade Register (through the Netherlands Authority for the Financial Markets, if applicable) will suffice."

Publication
The report on payments to governments must be published within the specified period after the end of the financial year in the same way as the publication of the financial statements (Article 3(1) of the Decree on reporting payments to governments). This implies that issuers send the report to the Netherlands Authority for the Financial Markets (Articles 5:25e and 25m of the Financial Supervision Act) within six months of the end of the financial year. Large entities and other public interest entities file the report with the Trade Register (Article 2:394(1) NCC) within 12 months of the end of the financial year.

Banks and investment entities
Banks (referred to in Article 1:1 of the Financial Supervision Act) and investment firms (referred to in Article 4(1)(2) of the Capital Requirements Regulation) are subject to specific provisions to disclose specific country-by-country information (Article 3 of the Decree implementing disclosure requirements for the capital requirements directive; *Besluit uitvoering publicatieverplichtingen richtlijn kapitaalvereisten*).

1.9 Sanctions on non-compliance with financial statement obligations

Criminal sanctions
Failure to comply with the following legal requirements regarding financial statements, as set out in Title 9 Book 2 NCC, constitutes an economic offence (Article 1(4) of the Economic Offences Act). For unlisted companies, this concerns:

- notice to all members or shareholders if, after the adoption of the financial statements, they are found to be seriously deficient and filing of a notice to this effect with the Trade Register including an auditor's report where required (Article 2:362(6) NCC, last sentence);
- commissioning an audit of the financial statements (Article 2:393(1) NCC);
- filing the financial statements with the Chamber of Commerce no later than 12 months after the end of the financial year (Article 2:394(3) NCC). For financial years starting before 1 January 2016, a 13-month period applies, except for financial statements to which the Accounting Directive Implementation Act (*Uitvoeringswet richtlijn jaarekenin*g) has been applied early;
- various requirements regarding the publication of financial statements other than by filing them with the Chamber of Commerce (Article 2:395 NCC);
- complying with an order of the Enterprise Division as to the manner in which the financial statements, management board report or Other information should be presented (Article 2:451(2) NCC).

Under the Economic Offences Act, violation of these requirements is punishable by a fine and/or imprisonment. Deliberate publication of misleading financial statements or other misleading figures may also constitute a criminal offence under certain circumstances. The Penal Code imposes a criminal penalty on this offence, which is essentially a particular form of forgery.

Civil law claim for compliance with the obligation to prepare financial statements
If an entity unjustifiably fails to comply with financial statement obligations, such as the publication requirement (see also paragraph 1.4), any stakeholder can go to court to enforce compliance. Any stakeholder may require the entity to comply with the publication of the financial statements in the manner prescribed by Title 9 Book 2 NCC (Article 2:394(7) NCC). This civil action may be brought before the court of the district in which the – defaulting – entity is domiciled.

This is also the case for non-compliance with the audit obligation. If an entity has wrongly failed to have its financial statements audited by a duly authorised auditor, any stakeholder can go to court (Article 2:393(8) NCC). The civil action for compliance with the audit of the financial statements may also be brought before the court of the district in which that entity is domiciled.

Management board members' liability
For management board members of a public or private limited liability entity – and, under certain circumstances, management board members of a commercial association or foundation – failure to comply with the requirement to publish financial statements, or failure to do so on time, may also lead to joint and several liability. Indeed, failure to comply with the publication requirement constitutes improper performance of duties by the management board. In the event of bankruptcy, the legal presumption then arises that this improper performance of duties is a major cause of the bankruptcy, so the management board members may be jointly and severally liable to the creditors for the amount of the company's debt. This creates a reversal of the burden of proof. The onus is on the management board member to prove that there is no connection between their (improper) performance of duties and the bankruptcy.

If the financial statements and/or the management board report, or interim figures, give a misleading presentation of the company's situation, the management board members are jointly and severally liable to third parties for any damage suffered by those third parties as a result.

1.10 Financial statement proceedings

Enterprise Division
If a set of financial statements does not meet the legal requirements, stakeholders can initiate financial statement proceedings before the Enterprise Division of the Amsterdam Court of Appeal. A stakeholder who believes that financial statements do not meet the requirements may request the Enterprise Division to order the entity or company concerned to present the financial statements in accordance with directions to be issued by the Enterprise Division. These specific financial statement proceedings are part of Title 9 Book 2 NCC, namely section 16 Judicial Procedure (Articles 2:447 to 455 NCC). A stakeholder may file a petition regarding financial statement proceedings with the Enterprise Division within two months of the adoption or filing of the financial statements with the Chamber of Commerce, or within two months of the disclosure of a deficiency that was not apparent from the annual accounts. If proceedings concern a securities issuer, whose financial reporting is supervised by the Netherlands Authority for the Financial Markets under the Financial Reporting Supervision Act, the aforementioned deadline for bringing financial statement proceedings is not two months but nine months.

The petition should set out the specific objections of a stakeholder or stakeholders to the financial statements and why, in their opinion, they do not comply with the legal requirements or do not comply with the IFRS-EU requirements. If the company contests this, the stakeholder will have to state why they are a stakeholder. The Enterprise Division will treat the petition with the utmost urgency. Financial statement proceedings take place in a closed session (in camera) at which the auditor concerned is also given the opportunity to be heard on the issues mentioned in the petition. Judgments (rulings) of the Enterprise Division in financial statement proceedings are public. No appeal is possible against such a ruling. However, cassation to the Supreme Court is possible.

2 General accounting principles

2.1 Purpose and function of financial statements

Although there are many forms of external reporting, the focus of this manual is on financial statements. Financial statements are defined as the company-only financial statements and the consolidated financial statements if the entity prepares consolidated financial statements (Article 2:361(1) NCC). The purpose of financial statements is to provide information about a company's financial position, its performance and changes in a company's financial position. This information is important for a wide range of users to make economic decisions. These could include buying, holding or selling interests in companies or whether or not to enter into transactions with the company. To meet those information needs, the financial statements should meet the common needs of the users of those financial statements as much as possible.

Financial statements are an important, but not the only, document on the basis of which economic decisions can be made. This is because financial statements reflect the financial consequences of events that have already taken place, while future information is usually also needed to make economic decisions.

Financial statements present the financial outcomes of the management conducted by the board of a company. Consequently, the financial statements also account for how the board has handled the entrusted cash. Partly on the basis of the financial statements, shareholders can judge whether or not to discharge the board from liability for its management.

2.2 Stakeholders in the financial statements

The financial statements are of interest to a large group of stakeholders. Stakeholders in the financial statements include:

Investors	These providers of venture capital are interested in the risk associated with their investment and the direct and indirect revenue it generates. Financial statements are also a source of information for their decision to take, hold or dispose of an investment.
Employees	Employees and employees' organisations are interested in information on the solidity and profitability of the company and the related possibility of paying employee benefits.
Lenders	Lenders are interested in information enabling them to assess the company's ability to pay the agreed interest and repayments on time. Potential lenders can assess, partly on the basis of the financial statements, whether or not they will provide credit to the company and on what financing terms.
Suppliers	Suppliers are interested in information showing whether or not their receivables can be paid on time.
Customers	Customers and especially those customers who have a more than occasional relationship with the company are interested in information regarding the continuity of the company's business.
Government	The government is interested in information about the company for the purpose of taxation, for example, but also in the context of policies to be pursued by the government.
Community	The community includes local residents in the immediate vicinity of the company. The company's impact on the immediate environment can be shown in the financial statements and covers environmental aspects, local employment, etc.

2.3 Standards for preparing financial statements

Legal standards

To meet all these information needs, the aim is to prepare financial statements in as standardised a manner as possible. The legislator has recognised this and issued regulations to be observed when preparing financial statements. These regulations are set out in Title 9 Book 2 NCC. The legislator has stipulated that the accounting principles on which the measurement of assets and liabilities and the determination of profit or loss are based must meet generally acceptable standards.

According to the Explanatory Memorandum to the first Annual Accounts Act of 1968, the Minister of Justice indicated that he expected the organised business community, together with the professional accountancy body, to identify and review the generally used accounting principles. This task is now performed by the Dutch Accounting Standards Board.

Dutch Accounting Standards Board

The Dutch Foundation for Annual Reporting was established in 1981. The board of this foundation now includes the employers' organisations (VNO-NCW and MKB Nederland), the employees' organisations (FNV and CNV), Eumedion and the accountants' organisation NBA. The Dutch Foundation for Annual Reporting aims to promote the quality of external reporting, in particular of financial statements, within the Netherlands by entities and other organisations. It seeks to achieve this goal by:

- publishing authoritative statements and recommendations on external reporting;
- providing solicited or unsolicited advice to government and other regulatory bodies on external reporting requirements.

The Dutch Foundation for Annual Reporting has established the Dutch Accounting Standards Board, which is charged by the board of the Dutch Foundation for Annual Reporting with drafting and publishing the aforementioned authoritative statements, recommendations and opinions. The Dutch Accounting Standards Board includes representatives of providers, users and auditors of companies' financial statements. The Dutch Accounting Standards Board considers it its duty to give substance to the standards for financial statements mentioned in Title 9 Book 2 NCC, which are generally acceptable. As early as 1980, the Minister of Justice explicitly stated that they considered this mission statement, as well as the way it is implemented, to be of great importance. In 2002, the Enterprise Chamber stated in a judgment (concerning KPN's financial statements), and also confirmed in subsequent judgments, that 'the Dutch Accounting Standards have to be considered as recommendations reflecting – evolved – societal views on the – further elaboration of – the legal regulation'.

In its standards, the Dutch Accounting Standards Board distinguishes between authoritative statements and recommendations. Although it is not the representation of the Dutch Accounting Standards Board that the authoritative statements have a binding force comparable to legal requirements (DAS 100.407), it has now been established, partly on the basis of rulings by courts and accountancy disciplinary bodies, that these guidelines give substance to the generally acceptable standards. This implies that authoritative statements are departed from only if there are good grounds for doing so on the basis of specific circumstances and an improvement is thereby intended and achieved in the insight provided by financial statements (DAS 100.407). The Dutch Accounting Standards Board assumes that a deviation from the authoritative statements cannot easily improve this insight (DAS 100.407). Both preparers and auditors of financial statements have their own responsibility in this.

European and international standards

Globalisation has greatly increased the need for international transparency and comparability of financial statements. Capital markets are integrating as a result of increased international communication capabilities, the introduction of the euro and the enlargement of the European Union. In this context, standards for preparing financial statements have been drawn up in a European and even global context. In European Union legislation, this is reflected in the European Accounting Directive (2013/34/EU). Member States have implemented this Directive in their national legislation. The European Accounting Directive (2013/34/EU) replaced the Fourth EC Directive (78/660/EEC) and the Seventh EC Directive (83/349/EEC) concerning the annual accounts of certain types of companies and consolidated accounts.

International Accounting Standards Board
The International Accounting Standards Board (IASB) is an independent body established to set financial reporting standards that can be applied worldwide. The IASB's mission is to achieve transparency, accountability and efficiency of financial markets around the world. European listed companies are required by an EC regulation (IFRS Regulation) to prepare consolidated financial statements based on the IASB's standards approved by the European Commission (IFRS-EU).

2.4 Conceptual framework

2.4.1 Introduction

A conceptual framework for financial reporting describes the objective of, and the basic principles (concepts) for, general purpose financial reporting. The Dutch Accounting Standards Board translated the "Conceptual Framework" published by the IASB in 1989 and subsequently published it as '*Stramien voor de opstelling en vormgeving van jaarrekeningen*' (Framework for the preparation and presentation of financial statements; '*Stramien*'). Incidentally, the *Stramien* is not formally part of the Dutch Accounting Standards; it is included in DAS 930. The IASB published a new conceptual framework in March 2018. This new conceptual framework has not yet been adopted by the Dutch Accounting Standards Board.

2.4.2 Basic principles

According to the *Stramien*, two basic principles should be used in the preparation of financial statements, namely:

a. the accrual principle (paragraph 22 of the *Stramien*);
b. the going concern principle (paragraph 23 of the *Stramien*).

Re a. The accrual principle
The accrual principle means that the effects of transactions and other events are not recognised in the financial statements at the time the related cash is received or paid, but at the time the transactions are entered into or the events occur. In this way, these transactions and events are reflected in the accounts and then in the financial statements in the period to which they relate. Financial statements prepared in accordance with this principle thus provide information not only on transactions completed by the receipt or payment of cash at the end of a year, but also on transactions not completed at the end of a year, in the form of receivables and payables existing at year-end and to be recognised in the financial statements.

The application of the accrual principle is illustrated by the following example.

Example: Accrual principle

Suppose that on 1 December, 1,000 items are purchased at a price of 10.00 each excluding VAT (= 12.10 including VAT), that on 15 December, 500 of these goods are sold and delivered at a price (including VAT) of 20 each (= 16.53 excluding VAT), and that both the payment of the purchase price, the receipt of the selling price and the payment of VAT take place in the month of January.

If the accrual principle were not applied, these transactions would not be recorded in any way as they did not result in movements in cash during the financial year. However, if the accrual principle is applied, the balance sheet reads as follows:

		D	C
Inventory	(= 500 x 10)	5,000	
Receivable	(= 500 x 20)	10,000	
VAT	(= (1,000 x 2.10) - (500 x 3.47))	365	
Profit	(= 500 x (16.53 - 10))		3,265
Debt	(= 1,000 x 12.10)		12,100
		15,365	15,365

Clearly, the application of the accrual principle provides a better insight into the nature and extent of the activities and profit or loss realised with them during the year in which the transactions take place.

The accrual principle is further elaborated in the realisation principle (for revenue accrual) and the matching principle (for cost accrual). Those principles are discussed below.

Re b. The going concern principle
The going concern principle implies that the preparation of financial statements is based on the assumption that the company is a going concern and will therefore continue in business for the foreseeable future. In making this assumption, it is assumed that the company has neither the intention nor the need to discontinue its entire business. It is important to start from this principle because, if the need or intention for discontinuity does exist, it may lead to different accounting principles. See also paragraph 2.12. The following simple example, in which we waive impairments, illustrates the difference for financial statements between going concern and discontinuity.

Example: Going concern principle

Suppose company A buys a car with an acquisition price of 50,000 and expects to drive the car for four years. The car's sales value in four years is estimated at 10,000. There is then a drop in value in the four years the car is used in the amount of 40,000. The depreciation method should be based on the expected pattern of use of the future units of output of the asset. A depreciates using the straight-line method. The actual course of the sales value during the four years of use of the car is likely to differ from the carrying amount during its useful life. With a valuation based on discontinuity, A would value the cars at the lower sales value.

Suppose the actual sales value at the end of year 1 is 35,000, at the end of year 2 26,500, at the end of year 3 17,500 and at the end of year 4 10,000, the difference in value at the end of each year can be shown as follows:

End-of-year valuation	Valuation based on going concern	Valuation based on discontinuity	Difference
Year 1	40,000	35,000	5,000
Year 2	30,000	26,500	3,500
Year 3	20,000	17,500	2,500
Year 4	10,000	10,000	0

Discontinuity can also affect items on the liability side of the balance sheet. Certain provisions will no longer be needed in the event of discontinuity and other liabilities arise precisely in the event of discontinuity (e.g. towards employees). Paragraph 2.12 discusses this in more detail.

Other principles
In addition to the basic principles mentioned above, there are four other principles to be observed. These are:

- the prudence principle;
- the realisation principle;
- the matching principle; and
- the principle of permanence or consistency.

This paragraph briefly describes these four principles.

Prudence principle
The prudence principle is enshrined by law in Article 2:384(2) NCC ('In applying the accounting principles, prudence shall be exercised'). The *Stramien* defines prudence as "the incorporation of a degree of care in forming judgements required in making the necessary estimates in situations of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated". However, the exercise of prudence does not permit the creation of hidden reserves or excessive provisions, or the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses (paragraph 37 of the *Stramien*).

Realisation principle
The realisation principle means that revenue or income is not recognised until it has been 'earned' as a result of the company's performance to the customer (delivery of goods or provision of a service). This principle is also enshrined

by law in Article 2:384(2) NCC ('Profits are only recognised to the extent that they have been realised at the reporting date'). As a rule, the recognition of income is limited to those items for which the amount can be reliably determined and which have a sufficient degree of certainty (paragraph 93 of the *Stramien*).

Matching principle

The matching principle means that revenues and costs relating to the same transaction or event are recognised in the profit and loss account at the same time (DAS 270.114), i.e. costs are recognised in the profit and loss account on the basis of a direct relationship between the expenses incurred and the "earning" of certain income (paragraph 95 of the *Stramien*). Thus, the costs of manufactured goods are recognised in the profit and loss account in the period that the revenues from those goods are recognised ('product matching').

Example: Matching principle

Company A sells a number of televisions at the beginning of year 1, giving customers the option to extend the standard warranty period from 1 year to 4 years. Warranty costs incurred by A in the first year after sale can be recovered by A from the manufacturer of the televisions. Warranty costs in years 2 to 4 will be borne by A. Those customers who took advantage of the option to extend the standard warranty period paid a total of 1,200 for this when they bought the televisions. The warranty in years 2 to 4 can be classified as a separate performance obligation.

The journal entry recognised by A on sale of the extended warranty period is then as follows:

Cash	1,200	
Accruals and deferred income		1,200

Based on empirical figures, A expects the following costs as a result of the extended warranty period:

Year 2	200
Year 3	300
Year 4	500
Total	1,000

If actual expenses match expected expenses, A recognises the release of accruals and deferred income to revenue as follows:

Year 2	240 (= 200 / 1,000 x 1,200)
Year 3	360 (= 300 / 1,000 x 1,200)
Year 4	600 (= 500 / 1,000 x 1,200)

In this way, the expenses and revenues associated with the extended warranty period are recognised simultaneously in A's profit and loss account.

In the absence of a direct link to revenues, expenses are allocated to the period to which they relate ('period matching').

However, the application of the matching principle does not allow the inclusion on the balance sheet of items not permitted by specific standards. An example are advertising and promotion expenditures. Under DAS 210.235, these are recognised as expenses at the time of delivery of the goods or services received.

Example: Not applying matching principle because of ban on capitalisation

Company A had catalogues printed at a cost of 10,000 which included a list of the best-selling products in its range and an order form. As at the reporting date, some of the catalogues are still in A's inventory. These will be distributed in the months following the reporting date. A wants to recognise this 'inventory of catalogues' on the balance sheet at the end of the financial year by virtue of the application of the matching principle. However, DAS 210.235 states that expenditures on promotional material (such as catalogues and leaflets) are recognised as expenses at the time the promotional material is delivered to the company. While such expenditures are incurred to obtain future economic benefits, no asset is acquired or created that can be recognised as such. The matching principle cannot be applied in this situation.

Principle of permanence or consistency
The principle of permanence or consistency or consistency concerns the requirement for:

- sequential consistency: only for good cause may the accounting principles be changed (Article 2:384(6) NCC). The same applies to the presentation in the balance sheet and profit and loss account (Article 2:363(4) NCC). Please refer to Chapter 3 on changes in accounting policies;
- simultaneous consistency: for assets or activities similar in nature and use, the same accounting principles are applied (DAS 140.202).

2.4.3 Qualitative characteristics of financial statements

According to the *Stramien* (paragraphs 24 to 46), in addition to these basic principles, qualitative characteristics apply when preparing financial statements. These financial statement requirements, provided they are properly applied by the preparers of the financial statements, ensure that the information contained in the financial statements is useful to as many users as possible because, when these characteristics are properly applied, the financial statements are, as far as possible, compiled in a uniform manner.

The main qualitative characteristics are:

a. understandability;
b. relevance (materiality);
c. reliability; and
d. comparability.

Re a. Understandability
The information provided by the financial statements should be understandable to the intended users. However, such users may be expected to have a reasonable knowledge of how business is done and how it should be reported. Moreover, users may be expected to take the necessary time to study the financial statements.

Re b. Relevance (materiality)
Information in the financial statements should be relevant. This is the case if this information allows users to assess past, present and future events, or to change or confirm the outcome of previous assessments. If this is the case, this information is useful for making economic decisions.

Whether information is relevant or not depends partly on the nature and materiality of this information. Certain information is relevant simply because of its nature. The information to be disclosed in the financial statements on directors' remuneration is an example.

Usually, however, the relevance of information will be determined by a combination of its nature and materiality. Information is material if its omission or misstatement could influence the economic decisions users make on the basis of the financial statements. The materiality of an item or error depends on its size, assessed under the particular circumstances under which the omission or misstatement occurs. The term 'material' thus provides a threshold or critical boundary, rather than being a primary qualitative characteristic that information must possess to be useful (DAS 115.207).

The term 'materiality' is also reflected in the insight requirement of Article 2:362(1) NCC as described in paragraph 1.1.6.2. According to the definition in the Dutch Accounting Standards, information is material if it is important for providing the insight referred to in Article 2:362(1) NCC. This occurs if the omission, misstatement or concealment of information could reasonably be expected to influence the economic decisions made by the users of the financial statements (DAS 115.0).

Conflict between understandability and relevance
There may be some degree of conflict between the understandability and relevance requirements in certain cases. This could include the situation where the information on complex issues cannot be displayed in an understandable way, if at all, for all intended users, when it needs to be disclosed given its relevance to certain groups of users.

In such a situation, the relevance requirement should be given a higher priority than the understandability requirement and the information should therefore be included. However, the requirement of understandability should also be explicitly considered in this context. An example of this apparent conflict is the information to be provided about certain financial instruments.

This information, which often takes up large chunks of text in some financial statements, is relevant but also often difficult to understand, especially for those who are not knowledgeable in these issues. The trick then is to present this complicated but definitely relevant and therefore indispensable information as understandably as possible. Then both requirements can be met.

Re c. Reliability
Information in financial statements is useful only if it is reliable. This occurs when information is free from material misstatement and bias and users of the financial statements may assume that the information faithfully represents what it is intended to represent.

Information is reliable if it gives a true and fair view of the transactions and other events reported. However, it should be borne in mind that absolute reliability of financial statements is an unattainable ideal. This is related to the fact that all financial statements contain items of a more subjective nature, especially through estimates. An example is a provision under a claim made by a third party against a company. In contrast, the balance sheet item 'cash' is an item of a more objective nature.

Aspects of reliability are:

- impartiality;
- prudence;
- completeness; and
- economic reality over legal form.

Impartiality
For information to be reliable, it must be impartial, i.e. the information must be reported without bias. Bias occurs when the compiler of information, in choosing what information to provide or not to provide and how it is presented, seeks to influence the decisions users make on the basis of that information.

Prudence
Another aspect of reliability is prudence. This aspect is applied to properly address the uncertainties that are inevitable in the preparation of the financial statements. Adequate consideration of existing uncertainties when making estimates should ensure that assets or income are not overstated and liabilities and expenses are not understated. However, prudence is different from unfounded pessimism. In fact, the latter can lead to non-neutral financial statements, making those very financial statements unreliable.

Completeness
Completeness is also an aspect of reliability. Deliberate or unintentional omission of information may result in the financial statements not meeting the requirement of reliability.

Economic reality over legal form ('substance over form')
As a final aspect of reliability, mention can be made of the requirement that information should be provided on the basis of economic reality and not solely on the basis of the legal form of the information ('substance over form'). A well-known example of this is leasing. With finance leases, the lessee (the one who uses the lease object) must recognise the lease object on the balance sheet, even though the lessor (the one who gives the lease object in use to the lessee) has legal title. Indeed, under finance leases, the lessee has beneficial ownership of the lease object. This is in contrast to operating leases where both legal title and beneficial ownership lie with the lessor. The distinction between operating and finance leases is sometimes not easy to make on literal reading of a lease contract. In determining the classification of a lease contract, it is the economic reality – what the parties had in mind when concluding the contract – and not the legal form, that is decisive.

Conflict between relevance and reliability
There can also be conflicts between relevance and reliability. This could include information that, while relevant, has little or no possibility of being reliably estimated in monetary terms. This issue can often be resolved by not including the relevant information in the balance sheet and statement of profit or loss, but rather in the notes to the financial

statements. In this way, an acceptable compromise can be reached between the requirements of relevance and reliability.

Re d. Comparability
Comparability concerns both comparability over time and comparability between different entities. Comparability of an entity's financial statements over different years allows users to assess developments in an entity's financial position and profit or loss. Comparability of financial statements of different entities allows users to assess the financial position and profit or loss of the entity in the light of the financial position and profit or loss of other entities.

2.5 Assets, liabilities, equity, income and expenses

The financial statements, which comprise the balance sheet, profit and loss account and notes, show the financial impact of transactions and other events. This is achieved by grouping these transactions and events into similar groups referred to as elements of the financial statements. According to the *Stramien*, these elements consist of assets, liabilities and equity for the balance sheet, and of income and expenses for the profit and loss account (DAS 930.47). It should be kept in mind that not all items classified as assets, liabilities, income or expenses qualify for recognition in the financial statements. To qualify for recognition in the financial statements, certain recognition criteria must also be met. See paragraph 2.6.

2.5.1 Assets, liabilities and equity

Assets
Assets are resources arising from past events, over which the company has control and from which future economic benefits are expected to flow to the company (DAS 930.49).

Assets is another word for property. A company's assets are used to produce goods or provide services, for which customers are willing to pay money. Future economic benefits are therefore embodied in assets. The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash to the company. That potential can also take the form of convertibility into cash or the ability to reduce cash outflows, such as when production costs decrease as a result of a change in manufacturing process.

The future economic benefits embodied in an asset can benefit a company in different ways. For example, assets can:

- be used in the production of goods or services to be sold by the company;
- be converted into other assets;
- be used to settle liabilities;
- be distributed to the owners of the company.

While a lot of assets can take a physical form, i.e. you can see and touch them, there are also assets for which this is not true. The best-known example is goodwill recognised as an asset on the balance sheet, paid when a company is acquired. A condition for being able to classify such goodwill as an asset is that future economic benefits are expected to flow to the company from it in the form of excess profits.

Many assets, both physical and non-physical, have legal rights attached to them, the most important of which is ownership. However, as indicated above, not only form, but also substance is important in assessing whether or not an item can be included in the financial statements. This means that the answer to the question of whether or not an item is to be classified as an asset will therefore depend not only on who is the legal owner of that asset, but in particular on who bears the economic risks in respect of that asset. The latter will have to include this asset in its financial statements.

Liabilities
Liabilities refer to existing liabilities of a company arising from past events, the settlement of which is expected to result in an outflow from the company of resources that embody economic benefits (DAS 930.49).

An essential characteristic of liabilities is that there is an obligation for the company. The best-known example is legally enforceable obligations arising from a contract entered into by the company, for example the purchase of goods, where a non-cash payment has been agreed. Borrowed loans are another well-known example. However, debt that is not legally enforceable can also qualify as a liability. For example, if a company's policy is to repair defects in delivered products free of charge, the amounts that are still expected to be spent on the free repair of goods already delivered also qualify as liabilities. Usually, the requirement is that a liability only exists if there is a balance between the liability and the consideration enjoyed, often consisting of goods delivered to the company.

Settlement of liabilities generally means that the company surrenders resources that embody economic benefits. Such settlement can be done in several ways, such as by:

- payment of cash;
- transfer of other assets;
- provision of services;
- replacement of the liability with another liability; or
- conversion of the liability into equity.

If the amount and/or the time when a liability will be settled are not certain, there may nevertheless be a liability to be recognised in the financial statements. Such a liability will usually be described as a provision. Well-known examples are the provision for deferred taxes and the provision for self-administered pension liabilities.

Equity
Equity consists of the residual interest in the assets of a company after deducting all its liabilities and is thus effectively a balancing item of all its assets less all its liabilities. However, this does not mean that this balancing item should not be subdivided. A BV, a private limited liability entity, is legally required to divide its equity into issued shareholders' equity, share premium, legal and statutory reserves and Other reserves. This breakdown is important for users of financial statements, for example because it provides information on the possibility of dividend distributions.

If equity is the balancing item of assets and liabilities, it will be clear that the amount of equity depends on the measurement of assets and liabilities. The various measurement methods are discussed in paragraph 2.8.

The equity shown in the financial statements will almost never equal the 'real' value of the company. This is mainly caused by the fact that the value of a company is determined prospectively and thus depends mainly on the possibility of future profit. The financial statements, on the other hand, are mainly retrospective and thus provide, among other things, an insight into past performance. While these provide partial insight into the possibilities of realising future profits, they do not provide insight into the value of those future profits and, consequently, the sale value of the company.

2.5.2 Income and expenses

Profit or loss consist of the balance of income and expenses. Before determining profit or loss, therefore, income and expenses must first be determined. It should be borne in mind that not all income and expenses must be necessarily recognised in the profit and loss account. The criteria that income and expenses must meet for them to qualify for inclusion in the profit and loss account are discussed below. To assess the nature and amount of income and expenses, it is relevant to assess the source from which they originate. The best-known distinction is that between income and expenses that do or do not arise in the ordinary course of business.

This distinction is important because the source of income and expenses is relevant in assessing a company's ability to continue generating cash in the future. This obviously applies to a significantly lesser extent to non-recurring income and expenses. It is therefore important to distinguish between the source of recurring income and expenses in the manner indicated.

Income
Income refers to increases in economic potential during the reporting period in the form of inflows of new assets or increases in existing assets, or in the form of reductions in liabilities, resulting in an increase in equity. The exception to this is the contribution from equity providers, such as the shareholders' equity to be paid up by them when new shares are issued, which is not classified as income.

Income consists of revenues and other benefits. Revenue is the result of carrying out the normal activities of a company. This could include revenues from goods and services sold and delivered, interest income, rental income, etc.

Other benefits are usually income that does not arise from normal business operations and is therefore more or less occasional in nature. An example is the profit made on the sale of a commercial building. Unrealised gains, which arise, for example, as a result of the revaluation of assets or the translation of participating interests denominated in foreign currencies, and which are recognised directly in equity, also constitute income. When other benefits are recognised in the profit and loss account, due to their mostly occasional nature, they are almost always recognised separately in the profit and loss account or in the notes thereto. This is because knowing them is useful for the purpose of economic decision-making.

The realisation of income is usually accompanied by the receipt of or increase in assets. The best-known example is the creation of or increase in receivables resulting from sales that lead to income. In addition, the realisation of income may be accompanied by a reduction in liabilities, for example by settling a loan at a fair value lower than its carrying amount.

Expenses
Expenses are reductions in economic potential during the reporting period in the form of outflows or depletion of assets, or the generation of liabilities, resulting in a decrease in equity. The exception is distributions to equity providers, e.g. in the form of dividend, which are not classified as expenses.

Expenses are subdivided into costs and losses. Costs are those expenses that arise in the course of normal business operations. This could include the cost of sales, wages and depreciation. These costs usually lead to an outflow of cash or inventories. However, costs may also not lead to an outflow of assets, but be caused by a depletion of assets, such as depreciation expenses on non-current assets.

Losses are other items that meet the definition of expenses. Losses, like costs, may arise in the course of normal business operations, but may also not arise from normal business operations and therefore be more or less occasional in nature. An example is the loss achieved on the sale of a commercial building. Unrealised losses, for example unrealised losses arising from the translation of foreign currency liabilities, also constitute expenses. When losses are recognised in the profit and loss account, they are usually shown separately in the profit or loss account or in the notes thereto, because being aware of them is useful for the purpose of economic decision-making.

2.6 Recognition of assets, liabilities, equity and income and expenses in the financial statements

Recognition of assets
Not all items classified as assets, liabilities, income or expenses qualify for recognition in the financial statements. However, to qualify for recognition in the financial statements, the following conditions must generally be met (recognition criteria) (DAS 115.104):

- it must be probable that the future economic benefits associated with the item will flow to the entity; and
- the item must have a cost or value, the amount of which can be determined with reliability.

The former condition shows that the requirement for recognition of an item in the financial statements is that it must be probable that the economic benefits will accrue to the company. Probability refers to the degree of uncertainty associated with it. The requirement of probability is met if the probability of occurrence is greater than the probability of non-occurrence (i.e. a probability greater than 50%). This will often require estimates. These estimates should be made based on the data available at the time of preparing the financial statements. Thus, whether or not a sale transaction may be recognised, and therefore whether an asset should be recognised in the form of a receivable and income in the form of sale proceeds, requires an estimate of the probability that the receivable will be received. For an individual receivable, this estimate should be made for that individual receivable. However, if there is a large accounts receivable portfolio, this estimate will, in principle, not usually be made by individual receivable, but for the total of the receivables. In that situation, it is therefore permissible under certain circumstances to make this estimate based on this total and to make a provision, and therefore a cost item, for the estimated unpaid bills. See paragraph 21.6.4.5.

Moreover, the requirement of probability of economic benefit is a condition for capitalisation of various items on the balance sheet, such as deferred tax assets and construction contracts for third parties.

A financial statement item must have a reliably determinable cost or value if it is to qualify for recognition in the financial statements. If no reasonable estimate of this cost or value can be made, then it is not permissible to include this item in the financial statements.

Incidentally, certain Dutch Accounting Standards include different recognition criteria. For example, for contingent assets, it is stipulated that they are only recognised on the balance sheet if it is virtually certain that their economic benefits will flow to the entity (DAS 252.521). Contingent assets are possible assets arising from events up to and including the reporting date, the existence of which depends on the future occurrence or non-occurrence of one or more uncertain events without the entity being able to exert decisive influence on them (DAS 252.0). See paragraph 20.2. For contingent assets, the Dutch Accounting Standards Board sets a higher requirement (virtually certain) than the requirement of probability included in DAS 115.104. The reason for this is the nature of contingent assets and the associated uncertainty regarding their realisation.

Liability recognition
Liabilities are generally recognised on the balance sheet when it is probable (DAS 115.105):

- the settlement of an existing liability will involve an outflow of resources that embody economic benefits; and
- the amount at which settlement will take place can be reliably determined.

The Dutch Accounting Standards Board has determined for financial instruments that these recognition criteria are met in all cases. However, for liabilities within the scope of DAS 252, these recognition criteria are explicitly included as conditions for recognition on the balance sheet. Liabilities under contracts that are unsettled or partially unsettled are not recognised as liabilities in the financial statements. Only when the assets are delivered or the services are provided does a liability to be recognised on the balance sheet arise. For example, investment commitments entered into are not recognised in the financial statements (see paragraph 7.2).

2.7 Subsequent events

Recognition of subsequent events in financial statements
As a reporting period is limited to, say, a 12-month period in the case of financial statements, the basic principles and characteristics described above become important. After all, at the end of a financial year, not all transactions have been completed and so decisions have to be made on whether or not to recognise assets, liabilities, income and expenses, and if the outcome is that these must be recognised, the amounts at which these items must be recognised will have to be determined.

However, the preparation of financial statements for a financial year equal to the calendar year does not take place on 1 January. The law requires private limited companies, among others, to prepare their financial statements within five months of the end of the financial year. Sometimes even that period is too short, which is why the law allows that, on the basis of special circumstances, the general meeting may extend this period by up to five months (up to a total of ten months) (Article 2:210(1) NCC). A generally significant period after the reporting date can therefore be discerned.

Subsequent events should be taken into account when preparing the financial statements. Here, the following periods are distinguished:

- reporting date to date of preparation of the financial statements;
- date of preparation of the financial statements to date of adoption of the financial statements (e.g. by the general meeting);
- period after this adoption.

With regard to subsequent events, the following two types of events are distinguished:

- adjusting subsequent events; and
- non-adjusting subsequent events.

The following table clarifies the types of events and the different periods, as well as the recognition or disclosure in the financial statements and the management board report.

Period	Adjusting subsequent events	Non-adjusting subsequent events
Reporting date to date of preparation of the financial statements	The impacts of these events should be recognised in the financial statements. The notes should be updated by including the new information.	The impacts of these events should not be recognised in the financial statements unless there is discontinuity.* Indicate in the notes in the event of a significant financial impact.** Report in the management board report the extent to which these events affected expectations.***
Date of preparation of the financial statements to date of adoption of the financial statements	The impacts of these events are only recognised in the financial statements and the notes are only updated to the extent indispensable for the required insight.	The impacts of these events should not be recognised in the financial statements unless there is discontinuity.* In certain situations relevant to the insight requirement, however, disclosure should be made in the notes.**
Period after adoption of the financial statements (and filing with the Chamber of Commerce)	If these events lead to the conclusion that the financial statements are seriously deficient in providing the required insight, shareholders should be informed immediately and a notice to this effect should be filed with the Chamber of Commerce. If these are audited financial statements, an auditor's report (audit opinion) should also be filed with this notice.	No obligations for any notification or other action.

* An event may not provide further information about the actual situation on the reporting date. However, if that event leads to discontinuity, the going concern principle can no longer be applied. The financial statements should then be prepared assuming liquidation of the entity's entire business (DAS 160.206). See paragraph 2.12.

** Subsequent events whose impact is not recognised in the financial statements but which are indispensable for the insight or have significant financial consequences must be disclosed in the notes as part of the financial statements (Article 2:362(4)-(6)/380a NCC).

*** The management board report must state to what extent special events that do not need to be taken into account in the financial statements have affected expectations (Article 2:391(2) NCC). This refers to events subsequent to the reporting date. See paragraph 1.1.6.3.3.

Application of consolidated accounting policies in company-only financial statements
Under IAS 10 'Events After the Reporting Period', impacts of subsequent events must be recognised in the financial statements (if these events relate to the relevant financial year) until the financial statements are prepared ('authorised for issue'). Under Dutch laws and regulations, events that are indispensable for insight should be recognised up to the moment the financial statements are adopted by the general meeting of shareholders. The question is how to deal with this if the company-only financial statements use the measurement bases of the consolidated financial statements (IFRS-EU) ('combination 3', see paragraph 1.2). The Dutch Accounting Standards Board stipulates that in this situation, subsequent events should be treated in accordance with IAS 10 (DAS 160.202a). This means that the impacts to be recognised under Article 2:362(6) NCC, of events that become apparent after the financial statements are prepared and provide further information on the factual situation as at the reporting date, are not recognised. This also applies if the company-only financial statements are prepared in accordance with IFRS-EU ('combination 4').

Disclosure of subsequent events in the notes and in the management board report
However, subsequent events that have significant financial consequences and whose impact has not been recognised in the financial statements must be disclosed. That disclosure should be included in the notes as part of the financial statements. This should include the extent of the financial consequences (Article 2:380a NCC). In addition, the management board report must disclose how special events that do not need to be taken into account in the financial statements have affected expectations (Article 2:391(2) NCC).

2.8 General accounting principles

2.8.1 Consistency

Choice of accounting policies
As stated above, items should only be recognised in the financial statements if their cost or value can be reliably determined. This means that items that qualify for recognition in the financial statements must be measured. Title 9 Book 2 NCC states that only those standards considered generally acceptable qualify for this measurement. Thus, before preparing its first financial statements, every company will have to choose a policy on measurement and, by extension, on determination of profit or loss.

Change in accounting policies
In principle, the company should continue to apply the accounting principles it has chosen (consistency). Indeed, under the provisions of Article 2:384(6) NCC, it is only permissible to opt for different policies if there are valid reasons for doing so.

Moreover, it is stipulated that the reason for the change must then be disclosed and an insight given into its significance for equity and profit or loss using adjusted figures for the financial year and for the previous financial year. For the recognition of changes in accounting policies, see Chapter 3.

Consistency in application
If a company has made a choice between the different accounting principles for certain assets or liabilities, the company should apply that choice consistently. Changing that choice is possible only if a change in accounting policies is applied.

For further discussion of the choice of accounting policies and consistency, please refer to Chapter 3.

2.8.2 Disclosure of judgements and estimates

In applying the accounting principles and rules for preparing financial statements, the management of the entity makes various judgements and estimates that may be essential to the amounts recognised in the financial statements. If necessary in order to provide the insight required by Article 2:362(1) NCC, the entity will disclose the nature of these judgements and estimates including the associated assumptions (DAS 110.129). See paragraph 30.10.

2.8.3 Value concepts

Pursuant to the provisions of Article 2:384(1) NCC, items that qualify as a basis for measurement of assets, liabilities and equity, and for determining profit or loss, are cost (purchase or construction cost) and current value, with the exception of certain intangible fixed assets (pursuant to Article 6 of the Decree on current value), inventories other than agricultural inventories (pursuant to Article 8 of the Decree on current value) and certain financial instruments (pursuant to Article 10 of the Decree on current value). Article 2:384(1) NCC stipulates that the management of the entity, in making its choice of measurement basis, must be guided by the purpose of the financial statements and generally acceptable standards (the requirements of Article 2:362(1)-(4) NCC). This provision is an important precondition for the choice of measurement basis. The chosen measurement basis must therefore result in financial statements that, according to generally acceptable standards, provide such an insight that an informed opinion can be formed on equity and profit or loss and, as far as the nature of the financial statements allows, on the solvency and liquidity of the entity.

In the legal text, the term 'current value' is used as a broad value concept and applies as an alternative measurement basis to historical purchase or construction cost. Several other value concepts, such as market value (called fair value by the Dutch Accounting Standards Board), net selling price, value in use and current cost (formerly: replacement value), are treated as representations of current value in the Decree on current value. The aforementioned value concepts are defined as follows:

Acquisition cost:	The acquisition cost of an asset is the cost at which it was acquired consisting of its purchase cost and ancillary costs (Article 2:388(1) NCC).
Construction cost:	The construction cost, which applies to self-constructed assets, includes the acquisition cost of the raw materials and consumables used and other costs directly attributable to the construction. It may also include a reasonable proportion of indirect costs and borrowing costs for the period attributable to the construction of the asset (Article 2:388(2) NCC).
Current cost:	The current purchase or construction cost, less depreciation (Article 2 of the Decree on current value).
Value in use (indirect net selling price):	The present value of estimated future cash flows attributable to an asset or combination of assets that can be obtained from the operation of the business (Article 3 of the Decree on current value).
Fair value (market value):	The amount for which an asset can be traded or a liability can be settled between knowledgeable, willing parties in an arm's length transaction (Article 4 of the Decree on current value).
Net selling price:	The maximum amount at which an asset can be sold, less costs still to be incurred (Article 5 of the Decree on current value).

These accounting principles show that a distinction is made between those based on historical cost and those based on some system of current value. In general, accounting principles should meet generally acceptable standards.

2.8.4 Current value information

In general, when applying the historical cost principle, the entity should provide additional current value information in the notes. At least, if the provision of the insight referred to in Article 2:362(1) NCC requires this (DAS 115.220). This applies accordingly to information on historical costs, if current value is used as the accounting principle in the financial statements. In addition, there are specific provisions in the law and the Dutch Accounting Standards on providing current value disclosures. An example is the disclosure of the fair value of financial instruments measured at cost, including derivatives. Another example concerns the disclosure of the fair value of investment property measured at cost.

2.9 Netting and settlement

Netting

If items are 'offset against each other', this is commonly referred to as 'netting'. By law, it is not permissible to offset assets or liabilities and equity or income and expenses against each other if they must be recognised in separate items under Title 9 Book 2 NCC (Article 2:363(2) NCC). DAS 115.305 states that receivables and liabilities should be netted in the financial statements if:

1. the entity has a legally enforceable right to settle the asset and liability, netted and simultaneously; and
2. the company also has the firm intention to settle the balance or the individual items at the same time.

It is important to recognise that both conditions must be met. Thus, having a legal right as such is not a sufficient condition. There should be a firm intention to settle the amounts on a net basis, so that the netted presentation also does justice to the true and fair view of the balance sheet and contributes to the judgement on the liquidity position of the entity.

The Dutch Accounting Standards do not further address the requirements for a legally enforceable right. In any case, it should be a legally enforceable right available to the entity at the time when the expected settlement of cash flows is about to take place. Given the speed of settlement of cash flows, this legally enforceable right will usually need to be available as early as the reporting date. The term 'legally enforceable' may indicate that there should be no doubt that by virtue of a contract, the net settlement will also be accepted by the counterparty. IFRS (IAS 32 AG38B) refers in this context to a legally enforceable right to which the following requirements apply:

1. The right must not be contingent on a future event;
2. The right must be legally enforceable in all of the following circumstances:
   a. during the ordinary course of business;
   b. in the event of non-performance of agreements by the counterparty ('default'); and
   c. in the event of bankruptcy.

In our view, these further requirements are also useful in the context of NL GAAP application. In any case, it is strongly recommended to check the legal enforceability in various situations, including in situations of breach of contract or bankruptcy. After all, in the event of the bankruptcy of the counterparty, the receiver could claim the part to be claimed from the entity while the entity's receivable against the counterparty remains unpaid and becomes part of the list of receivables to be filed against the counterparty. If soundness is in doubt because there is only a practice of net settlement without any legal agreement or ground, a separate presentation gives a better insight into the liquidity position and credit risk of the entity.

Netting is different from the legal term 'settlement', also referred to as 'set-off'. Indeed, settlement has the legal effect of eliminating individual items and replacing them with the balance of the set-off items.

Settlement
In certain cases, an obligation can be discharged by settlement. Title 1 Book 6 NCC, section 12, Articles 127 to 141 contain the legal regulation. The main regulations can be summarised as follows.

If party A has a receivable in the amount of X against party B, and also a debt in the amount of Y to the same party (in the case of party B, of course, this is the mirror image), then under certain conditions these receivables and debts can be set off (in legal terms: discharged in so far as the joint amount is concerned). These conditions relate to:

1. the right to settlement; and
2. the form of settlement.

Re 1: A right exists when both parties are each other's debtor and creditor. A's receivable against B must then be of the same type as B's receivable against A, such as cash receivables. Examples of receivables that are not of the same kind are a cash receivable and a claim to transfer of title of a property. Furthermore, there must be both a right to pay the debt and the enforcement of the payment of the receivable. The receivables must therefore be due and payable.

Re 2: Settlement is not automatic. A claim for settlement must be made through a settlement statement. This can be done in writing or orally, but it is advisable to put the statement in writing.

The settlement applies retrospectively from the time when the right to settlement arose or from the end of the last instalment on which interest due was paid. An exception to these settlement rules is a current account relationship maintained by law, custom or a legal act. Amounts booked into current accounts are settled immediately by operation of law; at any time, only the balance is due.

If one of the parties has issued a settlement statement, the other party can express its disagreement with it. There must be a ground for refusal to do so; that is, that party must have a ground to refuse performance of its obligation. A ground for refusal for a party is, for example, ongoing proceedings to set aside the contract from which its debt arose. Another ground for refusal is when that party makes use of its own right to settlement against one or more other receivables, but this is only possible if that settlement has further retroactive effect.

The legal regulation shown above is regulatory law. The parties may deviate from the legal regulation by contract. They can also agree to exclude settlement between them altogether, or agree that settlement is only possible by written statement.

2.10 Criteria for disclosure in financial statements

By law, the financial statements must enable users to form an informed opinion about the size and composition of equity and profit or loss and, as far as the financial statements allow this, about the solvency and liquidity.

On that basis, it is necessary that all data that are indispensable for such judgement be disclosed (materiality) and that the requirement of accessibility of the financial statements allows omitting disclosure of data that do not serve that required insight. The law therefore also provides that an item need not be separately disclosed in the financial statements if, in the financial statements as a whole, it is immaterial for the legally required insight (Article 2:363(3) NCC). Specifically required disclosures may be omitted to the extent that, taken by themselves and together with similar disclosures, they are immaterial to the insight (Article 2:363(3) NCC).

The starting point for the criteria for disclosure of data in financial statements is that the financial statements must meet the qualitative characteristics discussed above, namely understandability, relevance, reliability and comparability. After all, these characteristics lead to the financial statements containing the information that is useful for users' judgement. In addition, the law requires the disclosure of certain information at all times, i.e. regardless of whether its disclosure is necessary by virtue of the application of the qualitative characteristics. These are the mandatory disclosure in respect of movements in equity (Article 2:378 NCC) and the prescribed disclosure of the average number of employees working at the company during the year, specified in a way that is aligned with the organisation of the business and the disclosure of the number of employees stationed outside the Netherlands (Article 2:382 NCC). Also mandatory are the disclosures on the remuneration of - as well as loans, advances and guarantees granted to - the directors and supervisory board members of the entity (Article 2:383 NCC). With regard to directors and supervisory board members of open public limited liability entities (NVs), in addition to more detailed information on remuneration, information on the ownership of shares and options on shares in the entity must also be provided (Article 2:383b to 383e NCC).

Materiality criteria
The Dutch Accounting Standards provide some guidance on determining the criteria that lead to separate disclosure or not. It has been rightly pointed out that these quantitative criteria may be either too narrow or too broad in a specific case. Moreover, the typical details of the business and the nature of any data to be provided should be taken into account at all times. The legally required insight must be the key criterion here. If, based on these considerations, it is decided that certain information will not be disclosed separately, that information will have to be aggregated with similar items.

The following indicative criteria are mentioned (DAS 115.2):

	Criteria for separate disclosure
Balance sheet item	If an item is greater than 5% of the balance sheet total or greater than 10% of the section to which it belongs, provided the item to be disclosed separately based on these criteria is greater than 1% of the balance sheet total.*
Profit and loss account item	If the item is greater than 5% of value added or greater than 10% of the total of the section to which it belongs.*
Disclosure of, inter alia, name and address details and participation percentage of participating interests as specified in Article 2:379(1) NCC	If the value of the participating interest recognised on the balance sheet is greater than 5% of the balance sheet total according to the company-only balance sheet, provided that the total of the then undisclosed information is less than 15% of the balance sheet total according to the company-only balance sheet.*
Disclosure of, inter alia, name and address details of group entities to be included in the consolidation, as specified in Article 2:414(1) NCC	If the value of the assets of the consolidated company included in the consolidated balance sheet exceeds 5% of the value of the consolidated balance sheet total, provided that the total of the then undisclosed information is less than 15% of the balance sheet total according to the consolidated balance sheet.*

* The quantitative criteria mentioned are indications. In a specific case, these may be set too narrowly or too broadly. Assessment should always be based on the specific circumstances and particularities of the entity (DAS 115.213).

2.11 Distinction between non-current and current assets

On the balance sheet, assets are subdivided into non-current and current assets, depending on whether they are intended to serve the pursuit of the activity of the entity on a continuing basis or not (Article 2:364(1) NCC). The distinction between non-current and current aims to provide insight into a company's liquidity position. Criteria for the distinction between non-current and current assets should be chosen with a view to the purpose of this distinction for the financial statements.

Article 2:364(1) NCC states that if there is a long-term association, an asset is classified as 'non-current'. The use of the term 'long-term association' makes the understanding of liquidity dependent on the prudential significance of the asset. The primary criterion for recognising this significance is the function of the asset in the business process. The characteristic here is the usefulness of the continuous presence of the asset for the activity of the entity, the continuity being defined as "longer than required for the provision of a single good or service". The same asset is used for more than one production cycle to fulfil its function. Current assets therefore include inventories and accounts receivable that have arisen as part of the normal production cycle, even if they are not expected to be realised or otherwise utilised within 12 months of the reporting date. If the function of the asset is not helpful in classifying an asset as non-current or current, maturity may be helpful. This may be particularly the case with receivables (DAS 190.207).

An asset should be classified as current if (DAS 190.206):

- the asset is expected to be realised, or held for sale or use within the normal production cycle of the entity's operations;
- the asset is held primarily for sale or for the short term, and realisation of the asset is expected to occur within 12 months of the reporting date; or
- there is cash or cash equivalents that are not restricted in their use. A cash equivalent in this context means a readily marketable asset that is easily convertible into cash without restrictions and for which there are no significant risks of changes in value.

If part of the receivables included under financial non-current assets becomes due within 12 months of the reporting date, this amount should be disclosed separately or presented under current assets. The method of presentation should be explained (DAS 190.207).

2.12 Going concern assumption

2.12.1 General

Financial statements are prepared using the going concern assumption, unless that assumption is incorrect (DAS 170.101). This implies an assumption that an entity's entire business continues (Article 2:384(3) NCC). Here, the entity is deemed to be able to continue its operations without the need for liquidation or cessation of all business activities (DAS 170.101).

It is important to note that the going concern principle refers to the entity's *entire business*. Thus, the principle does not apply if only part of the business is discontinued. For the treatment of this, please refer to paragraph 30.5.

An important aspect concerns the manner in which the degree of uncertainty should be assessed in situations where an entity is expected to no longer be able to meet its obligations on its own. This is important for determining the extent of uncertainty about going concern. In that case, it is important to determine whether additional cooperation from stakeholders can be obtained. Consider, for example, the possibility of obtaining financial support from a shareholder or reaching a payment arrangement with a creditor. If necessary additional cooperation is possible but has not been confirmed at the time of preparing the annual accounts, there is an increased degree of uncertainty about going concern. In that situation, it should be assessed whether or not there is a material uncertainty. The conclusion could be that there are (1) concerns about going concern, but no material uncertainty, or (2) there is material uncertainty about going concern.

If it is sufficiently plausible that the necessary cooperation will be obtained, there is no material uncertainty about going concern. The assessment of whether it is plausible should be based on all the facts and circumstances. Therefore if the degree of plausibility is high, there need not be a material uncertainty about going concern.

This results in four different scenarios which are included in an overview in annex 1 to this chapter. For each scenario, it is indicated which principles should be applied and what disclosures are required. The scenarios are:

(1) no uncertainty about going concern;
(2) concerns about going concern, but no material uncertainty;
(3) material uncertainty about going concern; and
(4) inevitable discontinuity.

The assessment of whether the financial statements can be prepared based on a going concern assumption should be made according to the situation as of the date of preparation of the financial statements. After all, discontinuation or material uncertainty about going concern may also arise due to subsequent events. For example, deterioration in operating profit or loss and/or the financial position after the reporting date may trigger reconsideration of the assessment as to whether there is a material uncertainty about going concern (DAS 170.304). If, after preparation but before adoption of the financial statements, it appears that discontinuation is inevitable, the financial statements must be prepared on a liquidation basis (DAS 170.102).

Concerns about going concern, but no material uncertainty
If at the date of preparation of the financial statements there are concerns about going concern but no material uncertainty, the assets and liabilities and equity are measured on the basis of a going concern assumption and no specific disclosure is required on the going concern assumption. However, disclosure of the significant estimates and judgements (nature and assumptions), and uncertainties (nature and extent) may be required if it is needed to provide the required insight (DAS 110.129 and DAS 135.203).

Material uncertainty about going concern
Material uncertainty about the continuity of the entity's entire business exists when an entity will no longer be able to meet its obligations on its own. As long as there is uncertainty whether additional cooperation from stakeholders will be obtained or will be sufficient, but there is a real chance that the entity's entire business can be continued, the financial statements are prepared on the basis of the going concern assumption (DAS 170.302).

Based on all facts and circumstances, including the degree of plausibility of additional cooperation from stakeholders, it is assessed whether there is material uncertainty about going concern. Consideration is given to whether, if the cooperation of stakeholders is not yet entirely certain, whether such cooperation is probable to such a (high) degree that no material uncertainty about the going concern basis remains (DAS 170.302).

However, impairment of non-current assets may occur in this situation (DAS 170.301). The notes should state that material uncertainty about going concern exists and include an adequate explanation of the company's circumstances (DAS 170.305). In addition, the significant estimates and judgements (nature and assumptions), and uncertainties (nature and extent) shall be disclosed if necessary to provide the required insight (DAS 110.129 and DAS 135.203).

Example: Material uncertainty about going concern

Due to disappointing revenues, an operating company receives additional cash on current account from its parent entity every year. Without this liquidity, the operating company is unable to independently generate sufficient income to continue its operations. It is therefore dependent on its parent entity. At the beginning of year 2, even before the financial statements for year 1 are prepared, it appears that the parent entity itself is also at risk of financial difficulties. The parent entity is preparing a restructuring plan but the implementation of the restructuring measures that are in this plan has yet to start. Until the restructuring plan is final, the parent entity cannot commit additional liquidity to the operating company.

The operating company is unable to continue its operations independently. The operating company depends on additional liquidity from the parent entity, but it is still uncertain whether that additional liquidity will be obtained after the restructuring at the parent entity. Discontinuation is therefore not (yet) inevitable, but there is material uncertainty about going concern. The operating company's financial statements for year 1 can therefore be prepared on the basis of the going concern assumption. However, the operating company must include in those financial statements the disclosure that there is material uncertainty about going concern and include an adequate explanation of the company's circumstances. In addition, the operating company must disclose the significant estimates and judgements (nature and assumptions), and uncertainties (nature and extent) if necessary to provide the required insight (DAS 110.129 and DAS 135.203). Finally, the operating company must pay due attention to this in its management board report (see Chapter 1).

DAS 170.303 includes examples of events or circumstances that individually or together may be indicative of material uncertainty about going concern:

Financial indicators:

- relatively low or negative equity;
- ceasing to comply with funding covenants without clarity on the implications for continued funding;

- indications that debtors will not meet their obligations and/or that financiers will withdraw financial support provided;
- negative operating cash flows evidenced by current or forward-looking financial statements;
- significant negative operating profit or loss or significant declines in the value of assets used to generate cash flows.

Indicators from operations:

- the loss of an important outlet, concession or licence or an essential customer or supplier;
- personnel problems or a shortage of key raw materials.

The Explanatory Memorandum to Article 2:384(3) NCC indicates that in the event of material uncertainty about going concern, there may be grounds for measurement on a basis other than the usual one, such as the liquidation basis. However, this is generally only the case if there is no longer a realistic chance that the entity's entire business can be continued (DAS 170.301). Paragraph 2.12.2 discusses the further provisions of the Dutch Accounting Standards Board on the accounting principles to be applied in situations where discontinuity is inevitable. In Article 2:384(3) NCC, incidentally, the situation of 'material uncertainty' about going concern is indicated by the wording 'reasonable doubt' about going concern. For the situation where the financial statements are not prepared on the basis of the going concern assumption, please refer to the following paragraph.

Inevitable discontinuity
If discontinuity is inevitable, the financial statements should be prepared on liquidation basis. The same is true if inevitable discontinuity appears after the reporting date but before the adoption of the financial statements (DAS 170.102). Inevitable discontinuity exists if there is no realistic chance that the entity will be able to continue its business, because the entity will no longer be able to meet its obligations on its own and the necessary additional cooperation from stakeholders cannot be obtained (DAS 170.103). In fact, this is the case when there is a lack of liquidity and insufficient funding opportunities. For a description of the financial statements on the basis of inevitable discontinuity, see paragraph 2.12.2.

Example: Subsequent events and lapsed going concern assumption

An entity prepared its financial statements for year 1 on 31 March of year 2. In doing so, the entity relied on the going concern principle. The financial statements will be adopted by the general meeting of shareholders on 31 May of year 2. In the intervening period, it has become clear that the entity cannot obtain the necessary funding for its operations after all, which means that it can no longer meet its obligations and sustainable continuation of the entity's entire business has become impossible. The going concern assumption lapses. The impact on the year 1 financial statements is as follows:

- there is a subsequent event that does not give further information about the actual situation on the reporting date;
- because the financial statements for year 1 have not yet been adopted and the event causes the going concern assumption to lapse, this event should be recognised in the financial statements for year 1;
- this should be done by preparing the financial statements for year 1 on a liquidation basis.

The DASB does not elaborate on how the latter is given legal effect, e.g. whether the event should be recognised (1) in the financial statements already prepared or (2) in newly prepared financial statements. In practice, based on our experience, the second interpretation is usually chosen. Specifically, this means that the financial statements already prepared are 'recalled' and newly prepared financial statements (on a liquidation basis) are published, with date adjustment and – if applicable – a newly dated audit opinion (in view of the requirement in Article 2:393(7) NCC).

Other situations of discontinuity
By definition, an entity established for a fixed term is in a situation where the business operations will be discontinued. An example of such an entity is a construction consortium entered into for the duration of a single construction project and terminated when construction is completed. Or an investment company set up for the placement of a temporary investment that will be monetised according to a certain scenario, after which the balance will be distributed to the shareholders. In such a situation, there is no need to prepare financial statements on a liquidation basis, unless that entity cannot meet all its obligations upon discontinuation. The same applies to an entity where the management board (or any other authorised body) has decided to liquidate the entity or wind up its business, where that entity can meet all its obligations.

The Dutch Accounting Standards Board has therefore determined that there is no inevitable discontinuity in situations where (DAS 170.104):

- the entity is established for a definite period and the liquidation or cessation of all business operations occurs according to a scenario determined at the time of incorporation in which the entity is expected to meet all its obligations; or
- after the incorporation of the entity it has been decided to liquidate it or cease all business operations, with the entity expected to meet all its obligations.

In these situations, the financial statements are prepared on the going concern basis (and not on the liquidation basis), but nevertheless, the entity's entire business is not (or is no longer) continued. As a result, Article 2:384(3) NCC applies, just as in situations where there is inevitable discontinuity. Therefore, entities that find themselves in either situation must explain in the notes that the entire business will not be continued, communicating the possible impact on equity and profit or loss (Article 2:384(3) NCC). In doing so, the entity must explain the nature of its (remaining) business operations and an entity established for a definite period must also disclose that fact (DAS 170.104).

Despite the fact that in the above situations there is an expectation that the entity can meet all of its obligations, there may be material uncertainty about this expectation. If there is material uncertainty as to whether the entity can meet all of its obligations, the disclosure requirements that apply to material uncertainty as described above (DAS 170.104) apply by analogy.

2.12.2 Financial statements in the event of inevitable discontinuity

If discontinuity is inevitable, the going concern assumption lapses (Article 2:384(3) NCC). In addition, the notes should state the impact of the discontinuity on equity and profit or loss (Article 2:384(3) NCC). This therefore reflects the difference with the going concern valuation.

The DAS bundle includes standards for financial statements in the event of inevitable discontinuity. It describes the situations in which financial statements should be prepared on a liquidation basis of accounting ('liquidation principles'). The liquidation basis of accounting is applied in the event of inevitable discontinuity. The liquidation basis of accounting is not applied in financial statements of an entity whose activities are discontinued and which is able to meet its liabilities. This paragraph addresses:

- the content of the liquidation basis of accounting;
- recognition of the transition to the liquidation basis of accounting;
- presentation and disclosure requirements; and
- consolidation.

2.12.2.1 Content of the liquidation basis of accounting

General
In a nutshell, the liquidation basis of accounting implies that equity amounts to the expected liquidation balance. The rationale for this is that in the event of inevitable liquidation or discontinuation of all operations, users, as creditors and employees, will be mainly interested in the extent to which their (current but also future) receivables will be paid. Shareholders will mainly be interested in the balance available after settlement of all liabilities. The liquidation basis of accounting should therefore provide insight into the extent to which liabilities can be met and the balance that will be available after settlement of all liabilities.

This is achieved by (DAS 170.201):

- recognising all assets on the balance sheet – regardless of whether they were previously recognised on the balance sheet – and measuring them at the expected net selling price;
- recognising and measuring all liabilities at the amounts necessary to settle the items in question or at the best estimate of these amounts; and
- recognising accruals for expected future costs and revenues up to the expected liquidation date.

Recognition of assets
In the liquidation basis of accounting, all assets that will be sold separately must be recognised. This means that there is the possibility of recognising assets not recognised on the balance sheet under the going concern basis of accounting, such as an internally developed customer base or brand rights.

Measurement of assets
The net selling price is the maximum amount at which an asset can be sold, less costs yet to be incurred (Article 5 of the Decree on current value). This refers to the revenue that can be obtained in a market in which the entity does not normally operate. In the event of liquidation, the net selling price is also referred to as the liquidation value (Explanatory Memorandum to Article 5 of the Decree on current value). This means that measurement at net selling price is made based on the specific circumstances of the entity. In fact, therefore, an estimate has to be made of the amounts at which the assets can actually be sold.

Recognition of all assets at net selling price further implies that (DAS 170.202):

- write-ups are possible. These are recognised through profit or loss (see below). In addition, Article 2:390 NCC still applies and a revaluation reserve is recognised for this purpose, except where it is not required under Article 2:390 NCC (for example in the case of frequent market quotations);
- if a company is being sold, the net selling price of this company will be taken into account; and
- (deferred) tax assets are recognised and measured at the best estimate of the tax amounts that will be settled or received after the reporting date.

Recognition of liabilities
In the liquidation basis of accounting, all liabilities (provisions and debt) are recognised that are also recognised in the going concern basis of accounting. In terms of recognition, there are no differences between the liquidation and going concern bases of accounting. For financial liabilities, this means that they are not derecognised on the balance sheet until a transaction causes these liabilities to be extinguished (in accordance with DAS 290.702), for example by payment or waiver (DAS 170.203). This includes waivers that were not realised until after the reporting date, but before the preparation date. In the going concern basis of accounting, waivers after the reporting date are not recognised.

Measurement of liabilities
In the liquidation basis of accounting, all liabilities must be measured at the amounts necessary to (contractually) settle the relevant items or at the best estimate of these amounts. For debt, this tends to be face value. This is therefore no longer measured at amortised cost, but excluding premium or discount and transaction costs.

The liquidation principles for the recognition and measurement of liabilities further imply that (DAS 170.203):

- the measurement of liabilities does not take into account the entity's own credit risk. This means that no decreases in the value of debt (and therefore no profits) are recognised as profit or loss of the company being less creditworthy;
- provisions for existing liabilities are recognised and measured in accordance with DAS 252 on provisions; and
- (deferred) tax liabilities are recognised and measured at the best estimate of the tax amounts that will be paid after the reporting date.

Accruals for future costs and revenues
In order to reach the point where equity amounts to the expected liquidation balance, accruals for expected future costs and revenues are recognised on the liquidation basis of accounting. This includes the recognition of accruals for expected liquidation costs as well as for expected operating profit or loss after the reporting date, unless already included in the measurement at net selling price (DAS 170.204). Otherwise, there would be double counting.

In the liquidation basis of accounting, the accrual principle as applied when applying the going concern basis of accounting no longer applies. For example, no prepayments and accrued income are recognised for prepaid costs. After all, the net selling price is zero. Also, no accruals and deferred income are recognised for amounts received in advance. In contrast, accruals are recognised for, for example, rental amounts that will be paid or received after the reporting date, even if they relate to the period after the reporting date.

2.12.2.2 Transition to the liquidation basis of accounting

Prospective recognition
The transition to the liquidation basis of accounting is recognised prospectively. The difference from the carrying amount on the going concern basis of accounting (at the time of transition) is recognised in the profit and loss account. The comparative figures are not restated (DAS 170.205). The notes must disclose the impact of the discontinuity on equity and profit or loss (Article 2:384(3) NCC). This expresses the difference with the measurement on the going concern basis (DAS 170.206).

2.12.2.3 Presentation and disclosure

The entity sets out in the notes the effects of the discontinuity on its equity and profit or loss (Article 2:384(3) NCC). Furthermore, the presentation and disclosure requirements (including the provisions on legal reserves) of Title 9 Book 2 NCC and of the Dutch Accounting Standards apply in full (DAS 170.207), even if the financial statements are prepared on the liquidation basis of accounting.

Among other things, the entity forms a revaluation reserve under Article 2:390(1) NCC, insofar as write-ups in assets still present on the reporting date are credited to profit or loss. A revaluation reserve is not formed for assets for which frequent market quotations exist.

In the event of inevitable discontinuity, the entity should additionally disclose the following information (DAS 170.208):

- the facts and circumstances that led to inevitable discontinuity;
- a description of the liquidation plan or, if there is none, the expected method of liquidation;
- the methods and significant assumptions used in the liquidation-based valuation and significant uncertainties therein;
- the nature and amounts of significant positive and negative changes in value (including waivers) recognised on the profit and loss account; and
- the nature and amounts of costs and revenues recognised on the balance sheet up to the expected date of settlement.

An entity may continue to exist after dissolution, to settle its debts. In documents and notices issued by it, the entity must add 'in liquidation' to its name (Article 2:19(5) NCC).

2.12.2.4 Consolidation

An entity that is head of the group and ceases to prepare its financial statements on a going concern basis will, in principle, continue to be head of its group entities and will therefore prepare consolidated financial statements.

It may also be that an entity that is head of the group has a group entity that has been granted suspension of payments or declared bankrupt. From the moment a liquidator, administrator or receiver is appointed, there will no longer be a group relationship within the meaning of Article 2:24b NCC. Effective control in the former group entity is then no longer vested in the entity. This therefore breaks the group relationship with such 'group entities'.

2.13 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities. Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the legal minimum') in the notes.

2.14 Significant differences from IFRS

Disclosure of compliance with standards
IAS 1 'Presentation of Financial Statements' requires that if an entity complies with IFRS in the financial statements, this must be disclosed in the notes. This is only allowed if all IFRS requirements (standards and interpretations) are met, taking into account materiality. This requirement is not included in Title 9 Book 2 NCC and the Dutch Accounting Standards. Article 2:362(10) NCC requires the notes to disclose the standards according to which the financial statements have been prepared.

Deviation from a standard
IAS 1 requires an entity to depart from a standard in IFRS if compliance with the standard would be so misleading that it would conflict with the objective of the financial statements as set out in the Conceptual Framework. According to IAS 1, this will only occur in extremely rare circumstances. As a result, deviations from standards in IFRS are rarely possible. If deviation does occur, this should be disclosed in detail in the notes.

Dutch law (Article 2:362(4) NCC) stipulates that if it is necessary for the required insight, the entity must deviate from the legal regulations. The notes must explain the reason for the deviation, stating, if necessary, its impact on equity and profit or loss.

Authoritative statements in the Dutch Accounting Standards can only be deviated from if there are good reasons for doing so (DAS 100.407). The Dutch Accounting Standards Board believes that good grounds are present in any case if these deviations are intended to improve the insight provided by the financial statements and achieve this aim. The Dutch Accounting Standards do not explicitly require disclosure if deviating from authoritative statements. However, departing from an authoritative statement will usually involve management judgment that has a significant impact on the amounts recognised in the financial statements. The Dutch Accounting Standards state that – if necessary to provide the required insight – the nature of such a judgment should be explained (DAS 110.129). Additionally, the accounting policies applied must be explained (Article 2:384(5) NCC).

Events or transactions not covered by a standard
According to IAS 8 ‘Accounting Policies, Changes in Accounting Estimates and Errors’, if a particular transaction or event is not covered by a specific standard, other standards and interpretations addressing similar issues should be consulted first. Then, the provisions in the Conceptual Framework should be considered in selecting the accounting treatment. Also, the latest statements of, among others, other regulatory bodies and literature on reporting can be taken into account in resolving the issue, provided they do not conflict with the standards of the IASB and the Conceptual Framework.

DAS 110 ‘Objectives and assumptions’ requires that in such a situation, the board of the entity choose a recognition method that provides relevant and reliable information for user decision-making. Here, the other qualitative characteristics described in the *Stramien* should also be taken into account. DAS 110 emphasises the board's own responsibility for providing relevant and reliable information. This is in line with Article 2:362 NCC.

Subsequent events
Under IAS 10 'Events After the Reporting Period', effects of subsequent events should be recognised and/or disclosed in the financial statements up to the moment the financial statements are prepared ('authorised for issue'). Under Dutch law, events that are indispensable for insight should be recognised and/or explained up to the moment the financial statements are adopted by the general meeting of shareholders.

If the company-only financial statements are prepared on the basis of Title 9 Book 2 of the Dutch Civil Code applying the measurement basis that the entity has applied in the consolidated financial statements (IFRS-EU) (‘combination 3’; see paragraph 1.2), the effects of subsequent events are accounted for in accordance with IAS 10 (DAS 160.202a). This avoids having to deal with different time periods in the consolidated and company-only financial statements, with respect to the recognition of subsequent events (see paragraph 2.7).

Financial statements in the event of inevitable discontinuity
IAS 1 states that, in principle, financial statements should be prepared on the assumption that the entity is a going concern, unless management intends to liquidate the entity or discontinue operations, or there is no realistic alternative to going concern. If the financial statements are not prepared on the assumption that the entity is a going concern, this fact should be disclosed in the notes, along with the basis used to prepare the financial statements and the reason why the entity is not a going concern. There are no further provisions for the accounting principles to be applied in the situation when financial statements are prepared under the assumption that the entity is not a going concern. DAS 170 does, however, contain specific guidance on the preparation of financial statements in the event of inevitable discontinuity. DAS 170 also explicitly describes the situations in which financial statements should be prepared in accordance with the liquidation basis of accounting.

Annex 1. Continuity scenarios and relevant reporting requirements (based on annex 1 to DAS 170)

The overview below summarises the various going concern scenarios and associated reporting requirements. This overview should be read in conjunction with the full text of DAS 170, as well as the cited provisions in DAS 110.129 and DAS 135.203.

	Scenario 1: No uncertainty about going concern	**Scenario 2: Concerns about going concern, but no material uncertainty**	**Scenario 3: Material uncertainty about going concern**	**Scenario 4: Inevitable discontinuity**
Description	No events or circumstances that may cast reasonable doubt as to whether the entity can meet its obligations	Events or circumstances are present that may cast reasonable doubt as to whether the entity can meet its obligation, where there is no material uncertainty as to whether the mitigating measures are adequate	Events or circumstances are present that may cast reasonable doubt as to whether the entity can meet its obligations, where there is a material uncertainty as to whether the mitigating measures are adequate. However, there is a realistic chance that the entity can meet its obligations (DAS 170.103 and 302-304).	There is no realistic chance that entity can meet its obligations (DAS 170.103).
Accounting principles	Financial statements based on the Going Concern assumption.			Financial statements on the liquidation basis. (DAS 170.102, 105, 201-205 and 207)
	(DAS 170.101 and 105)		(DAS 170.101, 105 and 301)	
Disclosure	No specific disclosure on going concern	Significant estimates and judgements (nature and assumptions) and uncertainties (nature and extent) shall be disclosed if necessary to provide the required insight (DAS 110.129 and DAS 135.203).	Disclosure that a material uncertainty about going concern exists and an adequate explanation of the entity's circumstances (DAS 170.305). Significant estimates and judgements (nature and assumptions) and uncertainties (nature and extent) shall be disclosed if necessary to provide the required insight (DAS 110.129 and DAS 135.203).	Disclose that the whole of the entity's business is not continued including disclosing the effect on equity and profit or loss (DAS 170.206). Usual disclosure requirements of Title 9 Book 2 NCC (DAS 170.207). Specific disclosures related to inevitable discontinuity (DAS 170.208).
	If there is a discontinuity as referred to in DAS 170.104, this should be disclosed together with the possible effect on equity and profit or loss. Additionally, the nature of the (remaining) business activities should be explained and, where applicable, it should be stated that the entity has been established for a definite period of time (DAS 170.104).			-

3 Changes in accounting policies, changes in accounting estimates and correction of errors

3.1 Changes in accounting policies

3.1.1 Introduction

Accounting policy
Before financial statements can be prepared, an accounting policy must be chosen. An accounting policy comprises the set of principles and rules for preparing financial statements. An accounting policy consists of (DAS 140.0):

a. the basis for measurement and determination of profit or loss, namely:
   1. the basis for measurement of assets and liabilities;
   2. the basis for determination of profit or loss; and
   3. the criteria concerning the necessity or admissibility of direct movements in equity;
b. basis for consolidation, comprising of the rules for including or excluding subsidiaries, group companies and joint ventures in the consolidated financial statements and the rules for recognition of transactions between them;
c. basis for classification and other aspects of presentation, including grouping, aggregating, disaggregating and classifying items; and
d. Basis for preparing the cash flow statement, including the layout and other aspects of presentation of this statement, as described at c.

Change in accounting policies
A change in accounting policies occurs if one or more principles and/or rules of the accounting policy for the current financial statements are different from those used in the preparation of the previous financial statements. This includes the transition from an accounting policy that is not or is no longer considered acceptable to one that is considered acceptable (DAS 140.0).

Examples of a change in accounting policies
An example of a change in an accounting policy whereby the basis for measurement and determination of profit or loss are changed, is the transition from measurement of tangible fixed assets at historical cost to measurement at current value. An example of a change in accounting policies that affects the basis for the presentation of the financial statements is the preparation of the profit and loss account using the model by nature of expense, whereas previously the model by function was used. Changes in the classification of items also constitute a change in accounting policies related to principles for presentation. For example, a change in accounting policies regarding the preparation of the cash flow statement is to present cash flow from operational activities using the direct method, whereas the indirect method was used in the previous financial statements.

Not a change in accounting policies
A change in accounting policies does not include (DAS 140.0):

- first-time application of an accounting policy for items that did not previously occur or that was not significant;
- first-time use of an accounting policy for transactions or events that are, by their nature, different from those that occurred before;
- changes in accounting estimates (see also paragraph 3.2), such as changing the expected life for tangible fixed assets; changes in accounting estimates also include a change in the estimation method (e.g. a change in the depreciation method);
- a change in the consolidation scope due to a different qualification of a company without a change in the criteria for that qualification. For example, if there is no longer a controlling influence that causes the company to no longer qualify as a group entity and to no longer be consolidated, this does not constitute a change in accounting policies.

A change in accounting policies should be distinguished from changes in accounting estimates and from correction of errors. Paragraph 3.2 discusses changes in accounting estimates in more detail. Correction of errors is covered in paragraph 3.3.

3.1.2 Choice of accounting policy and consistency

Choice of accounting policy
Before an entity prepares its first financial statements, it must choose its accounting policies. Driving the choice of an accounting policy is the requirement set by Article 2:362(1) of the Netherlands Civil Code (NCC). It requires that financial statements provide insight to such an extent that an informed opinion can be made about the financial position and financial performance of an entity and, as far as possible, about its solvency and liquidity.

A choice of accounting policy also occurs when an accounting policy has to be selected in the financial statements for an item that did not previously occur or was not significant. Even if an accounting policy is used for the first time for transactions or events that are by their nature different from those that occurred before, this is a choice of accounting policy. In these cases, therefore, there is no change in accounting policies (DAS 140.0).

Consistency
The law lays down in several places the requirement of consistency of financial statements. The balance sheet with the notes must present fairly, clearly and consistently the size and composition of the assets (Article 2:362(2) NCC). The profit and loss account with the notes must present fairly, clearly and consistently the amount of profit or loss (Article 2:362(3) NCC).

Furthermore, the measurement of assets and liabilities and equity and the determination of profit or loss may be made on the basis of principles other than those applied in the previous financial year only for justified reasons (Article 2:384(6) NCC). Furthermore, the layout of the balance sheet and profit and loss account may differ from that of the previous financial year only for justified reasons (Article 2:363(4) NCC). The required consistency includes applying the same accounting principles and rules for assets or activities that are similar in nature and use (DAS 140.202). This is concurrent consistency.

An accounting policy, once chosen, should be maintained unless a change in accounting policies is mandatory or permissible (DAS 140.203). This is sequential consistency. Using the same accounting policy for preparing financial statements in consecutive years enhances the possibility of forming an informed opinion on the development of the entity's assets, profit or loss and cash flows (DAS 140.204). Thus, the choice of accounting policy aims to ensure that the financial statements provide the required insight in the relevant year. In addition, consistent maintenance of an accounting policy, once chosen, over a number of years ensures that insight is enhanced (DAS 140.205).

3.1.3 Changing an accounting policy

An accounting policy, once chosen, should be maintained unless a change in accounting policies is mandatory or permissible. The law states that there must be a justified reason for a change in accounting policies (Article 2:384(6) NCC). The decision on a change in accounting policies should focus on the improvement of insight (DAS 140.206).

A change in accounting policies is required if (DAS 140.206):

- It is required by law;
- it is required by the Dutch Accounting Standards ;
- the change leads to a significant improvement in the insight provided by the financial statements.

A change in accounting policies is permissible if there are justified reasons (Article 2:384(6) NCC). Examples include changes in accounting policies due to (DAS 140.207):

- a preference in the law or in the Dutch Accounting Standards for the application of an accounting policy other than the one used until then;
- starting to apply newly introduced alternatives in law or in the Dutch Accounting Standards;
- starting to apply an accounting policy that is standard practice in the industry in which the entity operates;
- starting to apply an accounting policy in line with international views;
- starting to apply an accounting policy applied by the entity's parent entity;
- a significant change in the nature of the entity's activities meaning that a changed presentation will provide a better insight into the entity's equity, profit or loss and cash flows.

3.1.4 Recognition of the impacts of a change in accounting policies

Retrospective recognition
A change in accounting policies should be applied retrospectively (retrospective recognition method), by recalculating equity at the end of the previous financial year based on the changed accounting policies. The difference between the equity at the end of the previous financial year before and after recalculation (referred to as the cumulative effect of the change in accounting policies) is recognised directly in equity at the beginning of the financial year in which the change in accounting policies was implemented. The example presented below in paragraph 3.1.5 presents two alternatives of how the impact of a change in accounting policies can be presented in the equity movement schedule. In the recognition of the cumulative effect, income taxes are taken into account (DAS 140.208).

The aforementioned recognition method should also be applied if a change in the consolidation principles (paragraph 3.1.1(b)) affects equity and/or profit or loss.

Prospective recognition
A change in accounting policy may be made without retrospective effect (prospective recognition method) if it is specifically prescribed or permitted. In addition, the prospective recognition method for a change in accounting policies is permitted only in the exceptional case where the cumulative effect cannot be reasonably determined. In that case, the carrying amounts at the beginning of the current financial year, based on the old accounting policy, should be taken as the starting point when applying the new accounting policy (DAS 140.209). There is therefore no recalculation of equity at the end of the previous financial year under the prospective recognition method. The new accounting policy is applied only from the beginning of the current financial year.

Application of new accounting policy
To ensure that the balance sheet, profit and loss account and cash flow statement are prepared using the same accounting policy, the new accounting policy should be applied to all transactions that occurred in the year in which the change in accounting policies was implemented (DAS 140.210). It is possible to decide on a change in accounting policies during the financial year or after the end of the financial year. In that situation, however, the new accounting policy must be applied for the entire financial year.

3.1.5 Comparative figures

Article 2:363(5) NCC stipulates that the amounts for the previous financial year shall be revised as necessary for the sake of comparability and the deviation resulting from the revision shall be explained. The adjustment of the comparative figures does not imply a change in the previous financial year's financial statements, but is made only for the sake of comparability (DAS 140.211).

The comparative figures for the previous financial year should be adjusted to reflect the changed accounting policies, with differences from the original figures indicated in the notes. This applies where relevant to the comparative figures of the balance sheet, profit and loss account, cash flow statement and statement of comprehensive income. If adjusting the comparative figures is impracticable, the reason for not adjusting should be disclosed, as well as the nature of the adjustment if it had in fact been made (DAS 140.211).

The cumulative effect of a change in accounting policies relating to periods prior to the previous financial year should not be presented as part of profit or loss of the previous financial year, but directly in equity at the beginning of the previous financial year (DAS 140.211).

Example: Change in accounting policies

A small entity used the "zero profit" method for the measurement of its construction contracts ("CC") until year 2 based on the provisions for small entities (DASsmall). This means that recognition of profit only takes place upon delivery or completion of the project. The following data have been extracted from the records based on the zero profit method:

CC end-of-year 1:	1,000
CC end-of-year 2:	1,200
CC end-of-year 3:	1,500

The impacts of taxation are waived in this example.

The equity movement schedule for year 3 with comparative figures for year 2 based on the zero profit method is as follows:

	Year 3	Year 2
Equity as at 1 January	15,000	10,000
Profit for the financial year	7,000	5,000
Equity as at 31 December	22,000	15,000

The profit and loss accounts are as follows (model by nature of expense):

	Year 3	Year 2
Net revenue	12,300	8,980
Sum of operating expenses	4,800	3,500
Operating profit	7,500	5,480
Interest income	100	80
Borrowing costs	600	560
Profit from ordinary activities	7,000	5,000

As the entity falls under the 'medium-sized' regime with effect from year 3, the entity switches to the "percentage of completion" method with effect from 1 January of that year, whereby profit is recognised in proportion to the services rendered in implementing the project.

For the purpose of the change in accounting policies to the percentage of completion method, the company has determined what profit mark-up on current projects must be capitalised in work in progress:

Profit mark-up in CC end-of-year 1:	400
Profit mark-up in CC end-of-year 2:	600
Profit mark-up in CC end-of-year 3:	1,000

For the purpose of this change in accounting policies, equity at the end of year 2 should be recalculated based on the changed accounting principles. This cumulative effect will be recognised by this company as a direct movement in equity in the opening equity of year 3. This company therefore uses the retrospective recognition method whereby the cumulative effect is recognised in equity.

In order to adjust the comparative figures for year 2, equity at the end of year 1 should also be recalculated based on the changed accounting principles. The cumulative effect relating to the years prior to year 2 should be presented as a movement in the opening equity of year 2.

Cumulative effect at end-of-year 1:	400
Cumulative effect at end-of-year 2:	600
Year 2 impact:	200 (= 600 - 400), so profit for year 2 becomes 5,200 (= 5,000 + 200)
Year 3 impact:	400 (= 1,000 - 600), so profit for year 3 becomes 7,400 (= 7,000 + 400)

The equity movement schedule for year 3 with comparative figures for year 2 in the financial statements for year 3 based on the percentage of completion method is now as follows:

	Year 3	Year 2
Equity as at 1 January	15,000	10,000
Impact of changed measurement of CC	600	400
Recalculated equity as at 1 January	15,600	10,400
Profit for the financial year	7,400	5,200
Equity as at 31 December	23,000	15,600

The notes disclose that the impact on profit for year 2 is 200.

Alternatively, it is possible to present the equity movement schedule for year 3 as follows, disclosing in the notes that the cumulative effect of the change in accounting policies on reported equity at the end of financial year 2 is 600 and that the effect on profit for year 2 is 200:

	Year 3
Equity as at 1 January year 2	10,000
Impact of changed measurement of CC	400
Recalculated equity as at 1 January year 2	10,400
Profit year 2	5,200
Equity as at 31 December year 2	15,600
Profit year 3	7,400
Equity as at 31 December year 3	23,000

The profit and loss accounts for years 3 and 2 after recognition of the change in accounting policies are as follows (model by nature of expense):

	Year 3	Year 2
Net revenue	12,700	9,180
Sum of operating expenses	4,800	3,500
Operating profit	7,900	5,680
Interest income	100	80
Borrowing costs	600	560
Profit from ordinary activities	7,400	5,200

The notes in the financial statements for year 3 following this change in accounting policies could read as follows:

To comply with the Dutch Accounting Standards for medium-sized and large entities, the company changed the measurement of its construction contracts from the zero profit method to the percentage of completion method on 1 January of the financial year. The comparative figures for the previous financial year have been adjusted to reflect the changed measurement method. The result of this change in accounting policies is an increase in profit of 400 in the financial year and 200 in the previous financial year compared to the profit under the old accounting policy. This increase in the profit relates to the item 'Net revenue' in the profit and loss account. The change in accounting policies has been recognised retrospectively, resulting in an increase in equity of 600 as at 1 January of the financial year and of 400 as at 1 January of the previous financial year. This increase relates to the item 'Construction contracts' in the balance sheet.

Multi-annual overviews
Amounts for years prior to the previous financial year included in multi-annual overviews should also be recalculated according to the new accounting policy. If this is not practicable, this fact should be disclosed. If it is not practicable to determine the cumulative effect of a change in accounting policies at the beginning of the financial year for previous periods, the entity should prospectively adjust the comparative figures in the multi-annual overview to the changed accounting policy from the earliest practicable date (DAS 140.212).

3.1.6 Notes relating to changes in accounting policies

All changes in accounting policies should be clearly disclosed in the notes, indicating how the new and old policies differ and the reasons that led to the change in accounting policies (DAS 140.213). This is in line with the provisions of Articles 2:363(4) and 384(6) NCC, which require that the justified reasons for changing the accounting principles must be set out in the notes.

For changes in accounting policies in connection with the basis for measurement and determination of profit or loss and criteria relating to direct movements in equity as mentioned in paragraph 3.1.1(a), the following information should be included in the notes (DAS 140.214):

- the method used to recognise the impacts of the change in accounting policies;
- the impact of the change in accounting policies for equity and profit or loss; and
- the impact of the change in accounting policies for individual items.

According to Article 2:384(6) NCC, insight into the impact of the change in accounting policies for equity and profit or loss can be obtained in two ways:

- equity and profit or loss for the current financial year are presented in accordance with the accounting policies applied in the previous year; or

- equity and profit or loss for the previous financial year are presented in accordance with the new accounting policies.

In any case, it is recommended to always reflect the impact of the change in accounting policies for the equity and profit or loss of the financial year itself, i.e. irrespective of the method used for recognition of the change in accounting policies (DAS 140.214). This will provide insight into the impact of the change in accounting policies in the year in which the decision was made and reported on. If it is not practicable to quantify this impact, it is recommended to describe the impact of the change in accounting policies qualitatively. This means that the impact of the change in accounting policies is shown for two financial years, namely the financial year in which the change in accounting policies is implemented and the previous financial year. Indeed, the impact for the previous financial year is reflected by disclosing the impact of adjusting the comparative figures in the manner described in paragraph 3.1.5.

If a reliable calculation or estimate of the significance of the change in accounting policies for equity and profit or loss is not possible, the reason should be disclosed in the notes (DAS 140.215).

If a change in accounting policies can be expected to have a significant quantitative impact on one or more subsequent financial years, a numerical indication of this impact should be given. If this indication cannot be determined, this should be disclosed in the notes (DAS 140.216).

3.2 Changes in accounting estimates

3.2.1 Introduction

Accounting estimates
Accounting estimates are made when preparing financial statements. This is due to uncertainties inherent in the activities of an entity. As a result, the size of certain financial statement items cannot be determined exactly, but only by estimation. When making an accounting estimate, the size of the item is approximated by taking into account all available relevant information as best as possible.

For example, accounting estimates will be made when assessing the collectability of accounts receivable for the purpose of determining the size of the bad debt provision. The useful life of intangible and tangible fixed assets must also be estimated as well as the condition of inventories for the purpose of determining the size of the provision for obsolete inventories (DAS 145.101). Accounting estimates also occur on the liabilities side of the balance sheet, including when determining the size of provisions.

Changes in accounting estimates
Changes in accounting estimates occur when a previous accounting estimate is revised. This may be necessary due to changes in the circumstances on which the accounting estimate is based or the availability of new information relating to the size being estimated. Changes in accounting estimates include changes in the estimation method (DAS 145.0).

Thus, a change in the estimation method also falls under the definition of changes in accounting estimates. An example is the change in the depreciation method for tangible fixed assets from linear depreciation to a reducing balance method of depreciation (e.g. as a fixed percentage of the carrying amount). It is sometimes difficult to distinguish changes in accounting estimates from a change in accounting policies. If this distinction is not clear, the change is recognised as changes in accounting estimates with adequate disclosure (DAS 145.102).

3.2.2 Recognition of changes in accounting estimates

Changes in accounting estimates must be recognised prospectively. Retrospective recognition is not permitted. This is therefore clearly different from the recognition method for changes in accounting policies, which, as indicated above, may only be recognised prospectively in exceptional cases (see paragraph 3.1.4).

The impact of changes in accounting estimates should be recognised in the profit and loss account (DAS 145.301):

- in the period in which the changes in accounting estimates occur, if the changes affect only that period; or
- in the period in which the changes in accounting estimates occur, as well as in future periods, if the changes affect both the current period and future periods.

Example: Change in accounting estimate (1)

In preparing the financial statements for year 1, a company estimated the anticipated warranty costs payable on products sold before the reporting date. To this end, the company recognised a warranty provision amounting to 50 at end-of-year 1.

In year 2, it appears that a manufacturing defect occurred last year in the manufacture of one of the company's products. The company now estimates owing a sum of 60 in warranty costs for products sold in year 1 and earlier. The additional expense of 10 is recognised in the profit and loss account for year 2.

Example: Change in accounting estimate (2)

A machine with a purchase cost of 100 is depreciated over 10 years. At end-of-year 4, the carrying amount is 60 and the expected remaining useful life is six years. During year 5, the expectation regarding the remaining useful life is adjusted to three years based on new technical developments.

In the financial statements for year 5, the depreciation charge on this machine will be adjusted from 10 to 20 (= 60 / 3). 20 will likewise be depreciated on this machine in the financial statements for year 6 and year 7, assuming no further changes in useful life expectancy. The carrying amount at end-of-year 4 is therefore taken as the starting point in determining the new annual depreciation expense. So, no catch-up depreciation takes place in year 5 to correct the hindsight-based underdepreciation in the previous four years. However, the shorter useful life may be an indication of impairment (DAS 121) and an impairment test will have to be performed in appropriate cases. If there is an impairment loss, the loss should be recognised directly as an expense in the profit and loss account (DAS 145.301). Therefore, allocating an impairment loss to future periods is not permitted.

The impact of changes in accounting estimates is recognised in the same section of the profit and loss account as the original accounting estimates. This is important for the comparability of successive financial statements (DAS 145.303).

DAS 145.301 states that changes in accounting estimates need not always result in recognition in the profit and loss account. If changes in accounting estimates affect only balance sheet items (the changes in accounting estimates result only in changes in assets and/or liabilities and/or a component of equity), the impact of the changes in accounting estimates is recognised by adjusting the carrying amount of the relevant balance sheet items in the period in which the changes in accounting estimates occur. An example is a change in accounting estimate in the amount of a deferred tax liability relating to a revaluation. The deferred tax liability is then adjusted to the related revaluation reserve.

3.2.3 Notes relating to changes in accounting estimates

If changes in accounting estimates are material for the reporting period or are expected for future periods, the nature of the changes in accounting estimates as well as the quantitative effect on the current period and future periods must be disclosed. If this quantitative effect cannot be determined, this should be disclosed in the notes (DAS 145.304-305).

3.3 Correction of errors

3.3.1 Introduction

Correction of errors distinguishes between material errors and other (non-material) errors.

A material error means an inaccuracy – identified after the financial statements have been adopted – such that those financial statements fail to provide the insight referred to in Article 2:362(1) NCC (DAS 150.0). A material error could be incorrect recognition, incorrect measurement and/or determination of profit or loss, as well as incorrect classification or an incorrect or incomplete disclosure. In considering whether there is a material error, the entity assesses whether the omission, misstatement or concealment of information, individually or together, could affect the economic decisions users make based on the financial statements. This depends on the size and nature, and is assessed on the basis of all the facts and circumstances (DAS 150.103). Both quantitative and qualitative considerations should therefore be included in this assessment.

Changes in accounting estimates are not considered errors if all available relevant information has been properly taken into account when preparing the financial statements. However, if, with unchanged circumstances, it is subsequently found that the available relevant information should have been interpreted differently, this is termed correction of errors, not changes in accounting estimates.

3.3.2 Material errors

Correction of material errors
A material error should be corrected in the first unadopted financial statements after the error is identified (DAS 150.201). A material error with an impact on equity is corrected as follows (DAS 150.202):

a. equity at the end of the previous financial year is recalculated as if the error had not occurred; and
b. the difference between equity at the end of the previous financial year before and after recalculation (the cumulative effect), is recognised as a direct change in equity at the beginning of the financial year in which the correction of the error takes place.

An example of a material error that has no impact on equity involves incorrect classification or incorrect or incomplete disclosure. This is corrected by applying the correct classification or making correct and complete disclosure.

Paragraph 3.1.5 includes an example detailing two alternatives of how the impact of a change in accounting policies can be presented in the equity movement schedule. This example applies mutatis mutandis to the application of the correction of material errors.

Adjustment of comparative figures
If possible, the comparative figures should be presented as they would have been if the material error had not been made (DAS 150.205). The recognition method for a material error and adjusting the comparative figures correspond to the retrospective recognition method for a change in accounting policies where the cumulative effect is recognised in equity (see paragraph 3.1.5).

Article 2:363(5) NCC states that the amounts for the previous financial year must be revised as far as necessary for the sake of comparability and the deviation resulting from the revision must be disclosed. This requirement must be met by adjusting the comparative figures, showing the differences from the original figures in the notes. If adjustment of the comparative figures is not practicable, the reason for not doing so should be disclosed as well as the nature of the adjustment if it had been made (DAS 150.205).

Multi-annual overviews
If amounts for previous financial years are also recognised in multi-annual overviews, they should be recalculated taking into account the correction of the material error, unless this is not practicable. In that case, this fact should be disclosed. When it is not practicable to determine the cumulative effect of the correction of the material error on all prior periods presented, the entity shall adjust the comparative figures from the earliest time it is practicable to do so (DAS 150.206).

Immediate action in the event of a serious deficiency
If the adopted financial statements are found to contain a material error such that those financial statements seriously fail to provide the insight referred to in Article 2:362(1) NCC, Article 2:362(6) NCC shall apply. The management of the entity must then immediately notify shareholders or members that these financial statements seriously fail to provide the required insight. This notice must also be filed with the Trade Register. If these financial statements have been examined in accordance with Article 2:393 NCC (audit by a competent auditor), then an auditor's report must also accompany this notice.

This provision also applies to any small entity that voluntarily has its financial statements audited in accordance with Article 2:393 NCC. This is because the small entity is then not using the audit exemption contained in Article 2:396 NCC.

Incidentally, we would emphasise that not every material error results in financial statements that are seriously deficient within the meaning of Article 2:362(6) NCC. After all, the legislator has chosen to use the word 'seriously' as a qualification of the degree of failure to provide the required insight. In the case of a listed entity, one can think of an error that is so important that, based on price sensitivity, a press release is necessary to inform the capital market as quickly as possible about the error and its effect on equity and profit or loss.

Disclosure
In addition to the disclosure of the adjustment of the comparative figures under Article 2:363(5) NCC (see above), the disclosure notes must state that there has been a correction of a material error. This should include the impact of correcting the error. In addition, the nature and, where applicable, the extent of the error should be disclosed (DAS 150.204).

3.3.3 Non-material errors

Correction of a non-material error
An entity must recognise the correction of a non-material error in the first financial statements yet to be prepared at the time the non-material error is detected. Any income or expenses arising from the correction of errors must be recognised in the profit and loss account in accordance with the nature of the item (DAS 150.203). DAS 150.203 does not provide for whether the impact of the correction of errors is recognised entirely in profit or loss for the financial year (i.e. prospectively), or through equity in accordance with the correction of a material error as described in paragraph 3.3.2 (i.e. retrospectively). In our opinion, based on DAS 150.203, both processing methods are permitted.

Adjustment of comparative figures
In the event of prospective recognition of correction of errors, comparative figures are not adjusted. After all, income and expenses relating to previous years are recognised prospectively in the current year's profit and loss account. In the event of retrospective recognition, adjustment of the comparative figures takes place as described in paragraph 3.3.2.

Notes
In the recognition of a non-material error in profit or loss for the financial year, it should be assessed whether disclosure is required under Article 2:377(7) NCC. That article requires that income and expenses which must be allocated to another financial year be disclosed according to their nature and extent. In the event of retrospective recognition, the adjustment of the comparative figures must be disclosed (Article 2:363(5) NCC).

Example: Correction of errors

During the financial year, a company is found to have under-recognised a bonus receivable amounting to 100 at the end of the previous financial year. The financial statements for the previous financial year have already been adopted and therefore cannot be restated. In this example, taxes are waived.

If this error is classified as a material error, it is corrected in the financial statements for the financial year by recognising it as a direct movement in opening equity as at 1 January of the financial year. The correction of this error therefore has no impact on the profit and loss account for the financial year. The comparative figures (receivable, equity, revenue and profit or loss) are presented as they would have been if this error had not been made, i.e. 100 higher than originally reported in the financial statements for the previous financial year. The adjustment of the comparative figures must be disclosed. In addition, if the financial statements for the previous financial year are seriously deficient, notice must be given to shareholders immediately on discovery of the error, in advance of its recognition in the financial statements. The notice must also be filed with the Trade Register, including the auditor's report to be attached to the notice (see paragraph 3.3.2).

If the error is not classified as a material error, it can also be corrected by including it in the profit and loss account for the current financial year. The profit for the financial year will therefore be 100 higher. The comparative figures will not be adjusted. The company assesses whether disclosure is required under Article 2:377(7) NCC.

3.4 Exemptions for medium-sized and small entities

Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the statutory minimum') in the notes.

3.5 Significant differences from IFRS

Changes in accounting policies
DAS 140 'Changes in accounting policies' has an additional disclosure requirement compared to IAS 8 'Accounting policies, Changes in Accounting Estimates and Errors' for changes in accounting policies that will have a significant quantitative impact on one or more subsequent financial years. This requires a numerical indication of this impact (DAS 140.216).

Changes in accounting estimates
Regarding the recognition of changes in accounting estimates, there are no significant differences from IFRS. IAS 8 has been amended, effective for financial years beginning 1 January 2023, to emphasise that estimates relate to monetary amounts subject to measurement uncertainty. Measurement techniques and input factors for valuation models are among the estimates. This is consistent with the definition of a change in accounting estimate (DAS 145.0) and the introductory paragraphs of DAS 145 'Changes in accounting estimates'.

Correction of errors
Regarding the recognition of correction of errors, there are no significant differences from IFRS.

Third balance sheet
In case of retrospective recognition (of a change in accounting policy or the correction of an error) with a material effect on the opening balance sheet of the comparative financial year, three balance sheets should be presented under IFRS. If one year of comparative figures is included, this means that the following balance sheets are included: a balance sheet at the end of the financial year, a second balance sheet at the end of the previous financial year and a third balance sheet at the beginning of the previous financial year.

There is no requirement to include a third balance sheet in the Dutch Accounting Standards.

4 Foreign currency

4.1 Introduction

Entities may carry out transactions in foreign currency and/or conduct their business (in part) in a country with a different currency. In addition, entities may, under certain conditions, prepare their financial statements in a currency other than the local or functional currency. This chapter explains how foreign currency transactions are recognised in the financial statements and how the financial statements are translated into the presentation currency when it differs from the functional currency. This also covers how a foreign operation is recognised. For the recognition of transactions for the purpose of hedging currency risk, please refer to Chapter 21.

Foreign currency
Foreign currency can be defined as any currency other than the functional currency of an entity. The functional currency is the currency of the economic environment in which the entity operates and the local currency is the currency of the country in which the entity has its registered office. Usually, the functional currency will be the same as the local currency. Presentation currency is the currency in which the entity's financial statements are presented. In many companies, the presentation currency will be the same as the functional and local currency. However, deviations can occur, for example when the functional currency is not the same as the local currency and some users still need a financial report that applies the local currency.

Example: Functional currency and deviant presentation currency

A Netherlands-based trading company BV H settles both its purchases and sales in USD. As a result, the company considers USD its functional currency. On grounds of requirements of its French parent entity, both the consolidation statements and the company-only financial statements must be prepared on the basis of the euro (presentation currency). Under the provisions of DAS 122, BV H will have to first express all transactions in its functional currency (USD). BV H thereby considers all transactions not denominated in USD (i.e. including those in euro) as foreign currency transactions. Those transactions should be converted into USD as described in paragraph 4.3.

To prepare the consolidation statements and company-only financial statements, USD figures must then be translated to the euro. This presentation currency is therefore different from the functional currency. That translation takes place as described in paragraph 4.4.

Foreign currency transactions
Foreign currency transactions are transactions expressed in a foreign currency or to be settled in a foreign currency, including transactions arising when an entity (DAS 122.0):

- buys or sells goods or services whose price is in a foreign currency;
- borrows or lends funds and the amounts payable or receivable are denominated in a foreign currency; or
- otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

Foreign operations
A foreign operation is a business conducted through a group entity, associate, joint venture or branch of the entity and whose activities are conducted in a country other than the entity's country or in a currency other than the entity's functional currency (DAS 122.0). A foreign operation can also be a branch or permanent establishment (DAS 122.105). For a foreign operation, translation to the presentation currency must be made if the functional currency of the foreign operation differs from the presentation currency, as described in paragraph 4.4.2.

Net investment in an operation
A net investment in a foreign operation is the amount of the entity's interest in the balance of assets and liabilities of that operation (DAS 122.0). A receivable from or payable to a foreign operation is also effectively part of the net investment, if the settlement of the item is not planned in the foreseeable future and it is not probable that the item will be settled in the foreseeable future. Trade receivables and trade payables are not part of the net investment in a foreign operation (DAS 122.112).

Example: Intercompany debt from normal operations (in the context of net investment in a foreign operation)

Company M BV, a Dutch holding entity, holds a 100% interest in the Mexican associate D. D's management decided at an earlier stage that the Mexican peso should be considered D's functional currency, as sales to third parties are made in Mexican pesos and salaries are also paid in Mexican pesos. D's purchased raw materials from M are settled in euros and have resulted in an intercompany receivable by M against D in euros. Previously, D paid this debt by instalments. However, there is no 'hard' evidence that the repayment of this intercompany debt is subject to certain repayment conditions.

Although it was not formally determined, M's management believes that part of the intercompany receivable from D qualifies as non-current and should therefore be recognised as part of the net investment in the foreign operation.

DAS 122.112 states that trade receivables and trade payables are not part of the net investment in a foreign operation. Therefore, in this situation, it is not possible to consider M's intercompany receivable from D as part of M's net investment in D. Furthermore, the fact that past repayments were made leads to the assumption that D intends to repay the debt to M. However, a part of the intercompany receivable could be considered as part of the net investment in the foreign operation if it is converted into a long-term receivable without a repayment obligation. Or, of course, if part of the intercompany receivable is converted into equity of D. The latter could be done by issuing shares D, with part of the receivable being contributed as a deposit on these shares. It could also be done by means of an informal capital contribution (e.g. by waiving part of the receivable).

Example: Current intercompany debt (in the context of net investment in a foreign operation)

The US company D is a 100% participating interest of the Dutch holding entity M BV. M provided euro-denominated loans to D. The loans have agreed maturities of six months to one year. Although the loans are current under the contract, M provides an annual confirmation stating that it will not call the debt in that year. In the past, the loans were taken out every year.

These short-term loans are not part of the net investment in D. To classify as net investment in a foreign operation, the settlement of such item should not be planned in the foreseeable future and it should not be probable that such item will be settled in the foreseeable future (DAS 122.112). Ongoing intercompany relationships are generally not classified as a net investment in a foreign operation. The holding entity M has only agreed not to demand repayments in the current year, but it has not committed not to do so in the foreseeable future.

A special situation arises if loans are granted to a foreign operation where, for tax reasons, it is contractually stipulated that part of the amount must be repaid over a period of, say, 10 years. The question is how then to interpret the criterion of 'the probability that the item will be settled in the foreseeable future'. In our view, the intention to continue the investment by the parent should then be expressly considered. If the foreign operation will not (or cannot) attract external financing itself, while the parent, through internal (re)financing, will continuously enable the subsidiary to repay the loan according to the tax schedule, there is no objection to counting the loan as net investment. *Ceteris paribus*, the amount to be repaid is then refinanced by the parent, allowing the foreign operation to continue its level of activity. Specific facts and circumstances, including how past intentions have been handled and multi-year plans for the foreign operation, will need to be considered in the judgement. The term 'foreseeable future' is not elaborated by the Dutch Accounting Standards Board. It is important to consider whether there is a part of the net investment in the foreign operation that *essentially* must be seen as part of the equity of this operation.

Monetary items
Monetary items are cash held in units of currency and assets and liabilities representing a certain fixed or determinable amount to be received or paid in units of currency (DAS 122.0). Examples include trade receivables, trade payables, cash, pensions and other employee benefits payable in cash, provisions to be settled in cash and dividends due that have been recognised as a liability.

In contrast, the main feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of currency units. Examples include shares, amounts paid or received in advance for goods and services before the related assets, costs or revenue are accounted for, goodwill, intangible fixed assets, tangible fixed assets, inventories and provisions to be settled by the delivery of a non-monetary asset.

4.2 Determining the functional currency

Functional currency
When preparing its financial statements, an entity should determine its functional currency. The determination of functional currency is made regardless of whether the entity is an independent entity, an entity with a foreign operation (such as a parent entity) or a foreign operation (such as a group entity, branch or permanent establishment) (DAS 122.105). It is therefore possible for an entity to have multiple functional currencies, for example in the case of a branch or permanent establishment abroad. An entity may also have different functional currencies for the purpose of preparing consolidated financial statements. For example, the functional currency of the entity itself may be the euro, while the functional currency of a group entity in the United States of America may have the USD as its functional currency.

Incidentally, the functional currency will usually be the same as the currency in the economic environment in which the entity receives and spends cash. The following factors are relevant for determining the functional currency (DAS 122.106):

- which is the currency that mainly determines the selling price of goods and services (this will often be the currency in which the selling price of the goods and services is expressed and settled);
- which is the currency of the country whose competition and laws and regulations mainly determine the selling price of its goods and services;
- which is the currency that mainly determines the labour, material and other costs of providing goods and services to the entity (usually the currency in which such costs are expressed and settled).

Furthermore, the following is relevant when determining the functional currency (DAS 122.107):

- which is the currency in which the funding was attracted; and
- which is the currency in which funds received from business activities are usually held.

Functional currency for foreign operations
The following factors are relevant in determining whether the functional currency of the foreign operation is the same as that of the entity (DAS 122.108):

- are the business activities of the foreign operation carried out as an extension of the entity, rather than carried out with a significant degree of independence?
- do the transactions with the entity form a significant or limited part of the foreign operation?
- do the cash flows from the foreign operation directly affect the cash flows of the entity and are they immediately available to be transferred to it?
- do the cash flows from the foreign operation's activities suffice to meet existing and foreseeable liabilities without the entity providing cash?

If the assessment of the above factors does not lead to an unambiguous conclusion as to what the functional currency is, the entity's management should determine that currency which most faithfully represents the economic consequences of the underlying transactions, events and circumstances (DAS 122.109). The Dutch Accounting Standards Board states that most weight should be given to the factors included in DAS 122.106. The factors included in DAS 122.107-108 are supplementary.

Example: Determination functional currency of foreign operation

Holding entity A (functional currency: euro) has three subsidiaries B, C and D. In A’s consolidated financial statements, euro is used as presentation currency.

Subsidiary B is a property investor in Norway. Its activities focus on direct return (rental income) and indirect return (increases in the value of the properties). At the request of tenants (often working in the oil/gas industry), leases are usually in US dollars (USD). B is often financed by sister D, often in USD in order to have a match with the rental income.

The rents (per m2) and the value of the property are highly dependent on local market conditions. The wages to B's staff are paid in Norwegian kroner (NOK).

Subsidiary C is based in London and deals with oil futures. A number of traders employed by C hedge the large open positions of subsidiary B and also arbitrates on the oil futures market. All contracts are settled in USD. The traders are paid in British Pounds (GBP) and the monthly rent payment of the office (only 50 m2) is also settled in GBP. London was chosen as the registered office because of the ICE Futures Europe exchange present there.

Subsidiary D is a Swiss financing vehicle (based in Zurich) that should be seen as an extension of the Holding. Subsidiary D borrows in euro on the capital market and lends out to its sister companies (B and C), mainly in USD.

The question is which functional currency A's subsidiaries have.

- Subsidiary B: Property is location-bound. The situation in the local Norwegian market drives rents and property sales prices and thus serves as the primary economic environment. The USD leases are more of a service to the tenants and not an indication of the primary economic environment in which B operates. This also applies to USD financing from D, which is driven more by practical motives (cash flow management in USD). NOK is therefore considered functional currency.

- Subsidiary C: The principal revenue-generating activity (futures settlements) is denominated in USD. Oil prices and derivative instruments are denominated in USD all over the world. The amount of costs (traders' salary and accommodation) in GBP is small in relation to amount and volume of trade transactions. The London office was not so much chosen to strategically operate the business in the British economy but is mainly related to a pragmatic consideration: the location of the derivatives exchange on which USD transactions are executed. USD is therefore considered functional currency for C.

- Subsidiary D: The borrowing and lending of capital is done in euros. Subsidiary D can also be seen as an extension of the Holding. The functional currency of D is therefore euro.

A functional currency once determined should not be changed unless the underlying transactions, events and circumstances have changed (DAS 122.110).

Example: Change of functional currency (1)

Company A's functional currency is the euro. A recognises the 43% interest it holds in the Mexican company M at net asset value. M's functional currency is the Mexican peso. During the financial year, M obtained a loan from third parties amounting to EUR 200 million. This loan was taken out in euros. Most of M's operations, salaries and purchases are in Mexican pesos and take place in the Mexican economic environment.

Since the majority of M's operations, sales, purchases, salary costs, etc. take place in Mexican pesos and Mexico is the country whose competition and laws and regulations mainly determine selling prices, M can continue to use the Mexican peso as its functional currency (DAS 122.106). According to DAS 122.107, significant third-party funding obtained in the same currency as the shareholder's functional currency may be a factor that may trigger the adjustment of the functional currency. However, more weight should be given to the factors mentioned in DAS 122.106 (sales, purchases, salaries, etc.). It can be concluded that in this situation, the new financing is not decisive for the change of functional currency from the Mexican peso to the euro.

Example: Change of functional currency (2)

A UK company A is a 100% subsidiary of company M. The euro is M's functional currency and A has historically determined pound sterling as its functional currency. The determination of A's functional currency is based on the fact that sales and purchases are predominantly made in pounds sterling, as is the payment of salaries. Changes in A's operations are taking place from the fourth quarter. A's sales fell due to the loss of several large contracts. M started using A's production facilities for its own sales orders. A has closed its sales department as it no longer needs it now that 80% of all sales are made to M. M has built a new factory to produce the raw materials, which A is using in its production process. At the end of the financial year, A started buying these raw materials from M. Previously, A purchased these raw materials from third parties. Based on the changes in A's operations, A expects mainly euro-denominated cash inflows and outflows (excluding salary payments).

DAS 122.215 stipulates that the functional currency is changed only when the underlying transactions, events and circumstances have changed. At A, there are sufficient indications that transactions, events and circumstances have undergone changes. For example, the currency of a significant proportion of sales has changed from pound sterling to the euro. Furthermore, it is plausible to assume that this change is not just temporary, as the sales department is closed. Secondly, the outgoing cash flow for the purchase of raw materials was also changed from pound sterling to the euro. The third thing to mention is that M has built a new factory to produce the raw materials that A will use. It can be concluded from this that this change is not temporary in nature. Within the overall strategic position of M's business, A's position has changed from an independent company to a production facility of M. Accordingly, A's functional currency has changed to the euro.

Translation in the case of foreign activities
A participating interest established in a foreign country will usually prepare its own figures in its own functional currency. If the participating entity has a different presentation currency than the participating interest, the participating entity must translate those figures to its own presentation currency. This is then a foreign operation that is translated as described in paragraph 4.4.2.

If the functional currency of the foreign operation is the same as that of the participating entity's presentation currency, then no translation is required. In that case, the figures of the foreign participating interest are already denominated in the presentation currency of the participating entity. In addition, the participating interest may provide its figures in a currency other than the functional currency, for example its local currency. In that case, translation to the participating interest's functional currency must take place first. This is done in accordance with the translation of own foreign currency transactions as described in paragraph 4.3.6.

4.3 Recognition of foreign currency transactions in the functional currency

4.3.1 Initial recognition

Foreign currency transactions should be measured on initial recognition in the functional currency by translation at the spot exchange rate on the date of the transaction between the functional currency and the foreign currency (DAS 122.201). This applies both to own foreign currency transactions and to transactions of a participating interest that, although located abroad, has the same functional currency as the participating entity. See also paragraph 4.3.6. The spot exchange rate is the exchange rate at immediate delivery (DAS 122.0). Hereinafter, the term 'exchange rate' will be used in this chapter. This term has a similar meaning to the terms 'spot exchange rate', 'rate of exchange', 'foreign exchange rate' and 'currency exchange rate'.

The transaction date is the date on which the transaction first qualifies for recognition. For practical reasons, an exchange rate that approximates the exchange rate on the transaction date is often used, for example by using an average rate for a week or month for all transactions that occurred in a specific foreign currency. However, if the exchange rate of a currency fluctuates significantly, then using an average rate for a period is not possible (DAS 122.202).

4.3.2 Recognition at reporting date

Monetary balance sheet items denominated in a foreign currency should be translated at the closing rate of the functional currency on the reporting date (DAS 122.203).

Example: Sharply fluctuating exchange rates around reporting date (subsequent events)

Company A is a Dutch company with a Russian subsidiary. The functional currency of this Russian subsidiary is the rouble. The subsidiary has euro-denominated debt. The exchange rate of the Russian rouble against the euro fluctuated significantly in the two months before the reporting date and the two months after.

According to DAS 122.203(a), monetary items measured in a foreign currency should be translated to the functional currency at the exchange rate on the reporting date, without reservation. It is not customary to use a rate which is after reporting date, even when exchange rates are highly volatile at or near reporting date. The closing rate is used to translate euro-denominated debt to rouble-denominated debt. Due to the high volatility of the exchange rate at or near reporting date, a disclosure of this may be necessary, especially when the failure to disclose this may greatly affect the decision-making of the users of the financial statements (DAS 160.404).

Non-monetary balance sheet items arising from foreign currency transactions that are measured on a historical cost basis are translated at the functional currency rate at transaction date or at the approximate exchange rate in accordance with DAS 122.202 (DAS 122.203). This means that a non-monetary asset (e.g. a tangible fixed asset) that is measured at historical cost and acquired in a foreign currency is measured at the historical exchange rate as applicable on the transaction date.

Non-monetary balance sheet items resulting from transactions in foreign currency and measured at current value are translated at the rate of the functional currency at the time the current value was determined (DAS 122.203).

Example: Non-monetary balance sheet items measured at historical cost in a foreign currency

Company A holds an investment in a Japanese company. A's functional currency is the euro. This investment has been measured at acquisition cost under Article 10(3) BAW because no active market exists for this investment and the market value cannot be reliably determined. A's initial payment for acquiring the investment was in Japanese yen and had an equivalent of EUR 4.3 million when the investment was acquired. On the reporting date, the investment is worth EUR 6 million when the historical cost in Japanese yen is translated at the euro exchange rate on the reporting date.

According to DAS 122.203(b), non-monetary items measured at historical cost should be translated at the foreign currency at the transaction date. The investment therefore remains measured at EUR 4.3 million.

Example: Prepaid amounts for tangible fixed assets not yet received

Company B has ordered a machine. B's functional currency is the euro. The price of the machine is USD 1 million. When the machine is ordered, a prepayment in the amount of USD 0.1 million is due. The prepayment will be made on 1 April of the financial year. At the time of prepayment, the rate is USD 1 = EUR 0.90. At that time, the prepaid amount is recognised under the item ‘prepayments on tangible fixed assets’ (non-monetary item):

Prepayments on tangible fixed assets(= USD 0.1 million x EUR 0.9)	EUR 90,000	
Bank		EUR 90,000

On 25 June of the financial year, the ordered machine will be delivered. The exchange rate at that time is USD 1 = EUR 0.95. B still owes USD 0.9 million. At the time of gaining control over the asset (time of delivery), the asset is recognised on the balance sheet:

Tangible fixed asset (= EUR 90,000 + EUR 855,000)	EUR 945,000	
Prepayments on tangible fixed assets		EUR 90,000
Accounts payable (= USD 0.9 million x EUR 0.95)		EUR 855,000

Thus, the initial measurement of the machine partly consists of the prepayment translated at the exchange rate at the time of the prepayment on 1 April of the financial year. This elaboration is in line with what is included by the IASB in IFRIC 22 'Foreign Currency Transactions and Advance Consideration'. IFRIC 22 addresses foreign currency transactions when an entity recognises a non-monetary asset or liability arising from the payment or receipt of a prepayment before the entity recognises the related asset, cost or revenue. IFRIC 22 states that the transaction date for the purpose of determining the exchange rate to be used is the date of recognising the non-monetary item (a prepayment asset or a deferred revenue liability). This also aligns with the provision in DAS 121 (as well as IAS 21) that the transaction date is the date on which the transaction (in our example: the purchase of the machine) is first eligible for recognition.

The carrying amount of some items is determined by comparing two or more amounts. For example, inventories are measured at cost or lower net selling price according to DAS 220. For a fixed asset for which there is an indication of impairment under DAS 121 'Impairment of fixed assets', the carrying amount of an asset is determined as the lower of the carrying amount (before possible impairment losses) and the recoverable amount of the asset. The carrying amount of such a non-monetary asset in a foreign currency is determined by comparing (DAS 122.205):

- the cost or carrying amount, as appropriate, translated at the exchange rate at the time the amount was determined (i.e. the exchange rate on the transaction date for an item measured at cost) with
- the net selling price or recoverable amount, as the case may be, translated at the exchange rate at the time the value was determined (e.g. the closing rate on the reporting date).

The consequence of this comparison may be that an impairment loss is recognised in the functional currency when it would not be recognised in the foreign currency, or vice versa.

Example: Determining the carrying amount of inventories with expected revenue in a foreign currency

Company A is a Dutch company that uses the euro as its functional currency. A purchases inventory that it has bought in pounds sterling for an amount of GBP 85 when the exchange rate is EUR 1 = GBP 0.61 and which it expects to sell in pounds sterling for an amount of GBP 100. At reporting date, the inventory is slightly damaged and A notes that the net selling price is GBP 90. On the reporting date, the exchange rate is EUR 1 = GBP 0.69.

According to DAS 220 'Inventories', inventories are measured at net selling price if at reporting date this price is less than the purchase cost. The question is how to deal with the fact that the net selling price is in a foreign currency.

When A determines the net selling price, the currency in which the (expected) sale will take place should be used. For A, this is pound sterling. On the reporting date, the carrying amount should be determined by comparing the following values and using the lower of the two:

- the purchase cost of GBP 85 translated at the exchange rate on the transaction date of GBP 0.61 (= EUR 139 (=GBP 85 / GBP 0.61));
- the net selling price of GBP 90 at the exchange rate on the date this value is determined (= EUR 130 (= GBP 90 / GBP 0.69)).

As a result, an inventory write-down of EUR 9 (= EUR 139 - EUR 130) must be charged to profit or loss. The logic of this write-down lies in the fact that the euro is the functional currency of A and that by selling in pounds sterling there is an exchange risk on the value of inventories. This situation may arise in situations where sales abroad are seen as an extension of company A. In the case of a (independent) foreign operation (e.g. in the United Kingdom), the functional currency is probably pounds sterling and therefore the inventory write-down does not come up. After all, the carrying amount in pounds sterling can be recovered.

As a result, an impairment amounting to EUR 9 (= EUR 139 - EUR 130) should be accounted for and the inventory measurement adjusted by the same amount.

4.3.3 Recognition of exchange differences

With regard to monetary items, exchange differences may occur between the time of the transaction (time of recognition of receivable or payable in the books) and the amount received or paid upon settlement of the transaction translated back to the functional currency. These exchange differences should be recognised in the profit and loss account. The same may occur when translating at reporting date to the functional currency of unsettled transactions. The resulting exchange differences are charged or credited to the profit and loss account in each reporting period until the settlement date.

Example: Recognition of exchange rate loss

Company B, whose functional currency is the euro, capitalised a tangible fixed asset with an invoice amount of USD 100,000 on 2 January. The relevant invoice was entered at the exchange rate of EUR 1 = USD 0.8895 on 2 January, being USD 100,000 / EUR 0.8895 = EUR 112,422.71.

The asset was paid for after 46 days, on 18 February. At that time, the exchange rate was EUR 1 = USD 0.8705.

So USD 100,000 / EUR 0.8705 = EUR 114,876.51 was paid. This represents an exchange rate loss of EUR 2,453.80.

B uses historical costs as its measurement basis. DAS 122.207 requires exchange rate changes between the time of (a) capitalisation and recognition of the debt and (b) the time of payment to be recognised in the profit and loss account. The tangible fixed asset therefore has an initial measurement (which is subsequently depreciated) of EUR 112,422.71, while the exchange rate loss of EUR 2,453.80 is charged to profit or loss.

The Dutch Accounting Standards do not prescribe under which item in the profit and loss account the exchange difference should be recognised. The method of presentation of exchange differences is discussed in more detail in paragraph 4.7.

The recognition of foreign currency cash flows in the cash flow statement is set out in paragraph 25.4.

Recognition of exchange differences when applying current value
As described, non-monetary balance sheet items measured at current value that are measured in a foreign currency should be translated at the rate of the functional currency at the time of measurement of the item. Any exchange difference arising on such items is recognised directly in equity as part of the revaluation reserve if the change in the value of the non-monetary item is also recognised in equity. This is the case, for example, when tangible fixed assets are measured at current value.

Example: Non-monetary balance sheet item measured at current value in a foreign currency

On 1 February, company A BV bought an apartment intended for own (business) use in the United States (US) and paid USD 50 million for it. The company determines that the apartment *is not* part of a foreign operation and that the purchase is therefore a transaction in foreign currency (DAS 122.201). The exchange rate on 1 February was USD 1.20 = EUR 1.00. As at 31 December of that year (reporting date), the apartment has not yet been depreciated as it has not yet been occupied. Because the value of the apartment in the local market is measured in US dollars, the company determines that this asset should be measured in foreign currency and then translated to the functional currency of A (euros).

The exchange rate on the reporting date is USD 1.18 = EUR 1.00 and the current value of the apartment on that date is USD 60 million.

The following journal entries should be made under DAS 122.201:

On initial recognition at the exchange rate on the transaction date (1 February):

Tangible fixed assets (= USD 50 million / EUR 1.20)	EUR 41,666,667	
Bank		EUR 41,666,667

When measured at current value (DAS 122.203(c)), the apartment is classified as a non-monetary item recognised at current value. The apartment should be remeasured at the exchange rate on the date of revaluation (in this case, 31 December). The current value of the apartment as at 31 December is therefore EUR 50,847,458 (= USD 60 million / 1.18). The following journal entry should be made as at 31 December:

Tangible fixed assets (= EUR 50,847,458 - EUR 41,666,667)	EUR 9,180,791	
Revaluation reserve		EUR 9,180,791

The above journal entry includes both the revaluation and the exchange rate impact.
Incidentally, we have abstracted from the effect of deferred taxes.

If a change in value is recognised in the profit and loss account, the related exchange difference is also recognised in the profit and loss account (DAS 122.209). This is the case, for example, when investment properties are measured at current value.

Non-monetary balance sheet items measured in a foreign currency
Monetary items can be denominated in foreign currency, such as a receivable held in pounds sterling by a company with euro as functional currency. These items are 'measured in a foreign currency' and exchange differences are recognised in profit or loss (see paragraph 4.3.6). But *non-monetary* items can also be 'measured in a foreign currency'. Two situations can be considered:

- non-monetary assets and liabilities exist in countries with a local currency (other than the functional currency of the reporting entity) without there being a foreign operation and therefore without a functional currency to be determined for this operation (see example above for illustration);
- non-monetary assets and liabilities exist in countries with a local currency (other than the functional currency of the reporting entity) while the business operation is an integral part of the parent's business operation (see the following example).

Example: Exchange rate or translation differences for non-monetary items measured in a foreign currency

Company A, whose main activities are in the Netherlands (functional currency: euro), has a financing branch in Zurich which, on behalf of A's CFO, attracts loans on the capital market and lends out money within A's group. A explicitly considers this Swiss activity to be an integral part of its own strategic financing policy and, as a result, has determined that the functional currency of this Swiss branch is the same as its own functional currency, i.e. the euro. The following non-monetary items arising from this foreign activity are identified by A:
- an office building measured at current value;
- furniture measured at cost;
- a provision for restoration cost measured at the best estimate of the expected expenditures.

These items have been purchased in Swiss francs (CHF) or will be settled in CHF, so it is also logical to first determine the measurement in CHF and then translate them to the functional currency euros.

The office building is measured at current value, so the closing rate on reporting date has to be used for translation to euro; the total difference in euro will be recognised directly in the revaluation reserve of company A (DAS 122.203).
The provision for restoration cost is measured at each reporting date on the basis of a best estimate (DAS 252). This is not formally a current value but translation against historical exchange rate does not serve the insight requirement of an item measured on the basis of a best estimate of a CHF cash flow. This means that this item is translated into euro on the basis of closing rates on reporting date and that the movement in euro is recognised in euro in accordance with DAS 252 via profit or loss.
The furniture is translated on the basis of the original exchange rates on transaction date which results in a one-off translation into euros which then results in historical cost in euros.

This situation must be expressly distinguished from the translation of foreign operations, where a functional currency must be determined on the basis of the criteria set out in DAS 122. DAS 122 stipulates that *all assets and liabilities* of the foreign operation must be translated into the *presentation currency* (say: euro) against the *exchange rate on reporting date* where these translation differences must be recognised *directly in the foreign currency translation reserve* as part of the equity (DAS 122.302). See also paragraph 4.4.2.

4.3.4 Recognition of exchange differences on monetary items included in the net investment in a foreign operation

Exchange differences arising from the translation of a monetary item included in the net investment in a foreign operation of an entity should be recognised in the foreign currency translation reserve in equity (DAS 122.211). In contrast, exchange differences arising from the translation of monetary items that are not part of the net investment in a foreign operation should be recognised in the profit and loss account (DAS 122.212). A group entity that has received a loan from the parent entity should recognise any translation differences in the profit and loss account, even if the loan with the parent entity counts as part of the net investment in a foreign operation (DAS 122.213).

Example: Loan granted to a foreign operation, recognition in subsidiary

Dutch company M (functional currency: euro) holds a 100% interest in subsidiary A (functional currency: US Dollar). M made a loan to A in euro that is part of a net investment in a foreign operation as referred to in DAS 122.211.

Subsidiary A should recognise the exchange difference on the EUR loan it took out (monetary item) in the profit and loss account. Thus, it may *not* recognise the exchange difference directly in its equity on the basis that its parent regards the loan issued as part of the net investment.

For the recognition by M (consolidated and company-only), please refer to the example 'Intra-group receivables or payables' in paragraph 4.4.2.

Example: Disposal of a foreign operation

The Dutch company M (functional currency: euro) holds a 100% interest in an English subsidiary A (functional currency: GBP). M made a loan to A in EUR that is part of a net investment in a foreign operation as referred to in DAS 122.211. Weakening of pound sterling has created a negative foreign currency translation reserve in M's equity over the years. At the beginning of the fourth year after purchasing the shares in A, the participating interest in A is sold with a profit of EUR 13 million. At that time, the negative reserve for translation differences amounted to EUR 3 million.

The cumulative translation differences should be recognised in the profit and loss account as part of gain or loss on disposal at the time of sale of participating interest A (DAS 121.311). In other words, the profit on the sale of A is EUR 10 million (= 13 - 3). The cumulative amount of translation differences recognised in the profit and loss account (EUR 3 million loss) is disclosed separately in accordance with Article 2:377(8) NCC.

Unlike IFRS (the IAS 21.48 paragraphs), the DAS do not address partial disposal of a foreign operation. A partial disposal can take place (1) by selling part of the shares or (2) by selling part of the activities of the business with the proceeds flowing back to the parent which reduces its net investment by this amount. The parent may also decide to repay part of the net investment to itself through a superdividend or repayment of capital.

The DAS state that at the time of disposal of the foreign operation, cumulative translation differences at the time of disposal must be recognised in the profit and loss account as part of the gain or loss on such disposal (DAS 122.311). In our view, including partial disposals under this disposal is in line with the insight requirement. This ensures that translation differences temporarily recognised in equity are responsibly related to the unwinding of the net investment in the foreign operation. The following example illustrates this.

Example: Partial disposal of a foreign operation

The Dutch company M (functional currency: euro) holds a 100% interest in an English subsidiary A (functional currency: GBP). M made a loan to A in EUR that forms part of the net investment in the foreign operation as referred to in DAS 122.211. Weakening of pound sterling has created a negative foreign currency translation reserve in M's equity over the years. At the beginning of the fourth year after purchasing the shares in A, M decides to divest 50% of the participating interest in A by selling shares. The purchasing party is company K. Thereafter, M and K continue as joint venture partners in A. M's 50% interest in A will be measured at net asset value in M's company-only and consolidated financial statements.

M makes a profit of EUR 6 million on the sale of the shares to K. The negative foreign currency translation reserve at that time amounted to EUR 3 million. In economic terms, this represents a 50% disposal on M's net investment in A. From this view and the authoritative statement in DAS 122.311, M attributes 50% of the cumulative foreign currency translation differences (EUR 1.5 million) to the sale. The profit to be recognised by M in the profit and loss account on the sale of the shares in A amounts to EUR 4.5 million (= 6 - 1.5). The cumulative amount of translation differences recognised in the profit and loss account (EUR 1.5 million loss) is disclosed separately in accordance with Article 2:377(8) NCC.

4.3.5 Recognising the change in functional currency

A functional currency, once determined, should not be changed unless the underlying transactions, events and circumstances have changed (DAS 122.110). See also paragraph 4.2. This means the functional currency cannot be changed just like that. The functional currency reflects the underlying transactions, events and circumstances relevant to the entity. The consequences of a change in functional currency should be recognised prospectively (DAS 122.214). An entity therefore translates all items to the new functional currency based on the exchange rate on the date the change occurred. For non-monetary items, the resulting translation differences are recognised as part of the cost of these items.

Translation differences held in the foreign currency translation reserve as part of equity are not recognised in the profit and loss account (at a later date). Only when the foreign operation is disposed of are the cumulative translation differences recognised in the profit and loss account (DAS 122.216).

4.3.6 Translation of foreign operations with the same functional currency

A participating interest may be located abroad and have a different local currency, yet may still have the same functional currency as the participating entity. In that case, the transactions of the participating interest should be translated as if they were the participating entity's own transactions in foreign currency. This means that:

- transactions during the year are translated at the exchange rate applicable on the date of the transaction;
- monetary balance sheet items on the reporting date are translated at the closing rate of the functional currency with exchange differences recognised in the profit and loss account;
- non-monetary items measured at historical cost are translated at the (original) transaction exchange rate. No exchange differences therefore arise; and
- non-monetary items measured at current value are translated at the closing rate with exchange differences recognised directly in the revaluation reserve.

If the functional currency of the participating interest based abroad is different from that of the entity, then there is a foreign operation that is translated as described in paragraph 4.4.2.

4.4 Presentation currency different from functional currency

4.4.1 Translation from functional currency to presentation currency

The law allows entities to prepare the financial statements or only the consolidated financial statements in a currency other than the functional currency if the activity of the entity or the international branching of its group so warrants (Article 2:362(7) NCC). Usually, the presentation currency will be the same as the functional currency. However, deviations can occur, for example when the functional currency is not the same as the local currency and some users still need a financial report that applies the local currency.

If the presentation currency differs from the functional currency, the translation from the functional currency (other than a currency that is subject to hyperinflation) to the presentation currency should be made as follows (DAS 122.302):

- assets and liabilities on each balance sheet presented (i.e. including comparative figures) should be translated at the closing rate on that balance sheet date;
- income and expenses for each profit and loss account should be translated at the exchange rates applicable at the time of the transactions. For practical reasons, a rate that sufficiently approximates the exchange rates on the transaction dates (e.g. the average exchange rate for the period or the closing rate on the reporting date) may be used to translate income and expenses. However, if prices fluctuate significantly, using the average exchange rate for a period or the closing rate on the reporting date is not possible.

Translation differences from the translation of assets and liabilities and income and expenses should be recognised in the foreign currency translation reserve as part of equity. The latter translation differences arise because:

- translation of income and expenses is done at the exchange rates on the transaction dates and translation of assets and liabilities is done at the closing rate. Such exchange differences arise on both income and expenses recognised in the profit and loss account and on income and expenses recognised directly in equity; and
- the translation of net assets at the beginning of the period at a closing rate differs from the previous closing rate.

These translation differences are not recognised in the profit and loss account because the changes in exchange rates have little or no direct impact on current and future cash flows from business activities.

For the concept of hyperinflation and the translation of hyperinflationary currencies, see paragraph 4.6.

Translation of issued capital
In financial statements in which a presentation currency is used that differs from the currency in which the issued capital is denominated, the issued capital is stated at the exchange rate at the reporting date (Article 2:373(5) NCC). The notes should then also state the exchange rate used and the amount of the issued capital in the currency unit in which the shares are denominated. This means that a Dutch entity whose issued share capital is euro-denominated who prepares financial statements in another presentation currency (e.g. USD) must translate the issued share capital in the financial statements to the exchange rate on the reporting date. The exchange difference arising on translation of the share capital at the closing rate is recognised in Other reserves (DAS 240.205).

Example: Recognition of issued share capital in financial statements with other currencies

The issued share capital amounts to EUR 40,000. The presentation currency is US Dollar. The euro/USD exchange rate at the time of incorporation of the company is EUR 1 = USD 1.10. On the reporting date, the euro/USD exchange rate is EUR 1 = USD 1.20.

	Issued share capital	Other reserves	Total
Moment of incorporation	USD 44,000 (= EUR 40,000 x USD 1.1)	0	USD 44,000
Reporting date	USD 48,000 (= EUR 40,000 x USD 1.2)	USD (4,000) (= EUR 40,000 x (USD 1.1 - USD 1.2))	USD 44,000

By translating the share capital on the reporting date at the closing rate, the share capital measured in euros (EUR 40,000) remains the same.

Change in presentation currency
A change in presentation currency constitutes a change in accounting policies (DAS 140). There must be a valid reason for making a change in accounting policies (DAS 140.206-207). The law indicates that international branching of a group may justify such a change (Article 2:362(7) NCC). A change in the presentation currency should be made retrospectively. In fact, the translation should be done as if this new presentation currency has always been used. So comparative figures should also be presented in the new presentation currency. Please refer to paragraph 3.1 on the recognition of changes in accounting policies.

4.4.2 Translation of a foreign operation

In a foreign operation, the assets, liabilities, income and expenses should be translated as described in paragraph 4.4.1 (translation to presentation currency), so that the foreign operation can be recognised in the financial statements of the reporting entity via (proportional) consolidation or recognition using the net asset value method (DAS 122.307). For foreign operations with a different local currency, but with the same functional currency as the entity, translation should be done as if they were the entity's own transactions in foreign currency (as described in paragraph 4.3.6).

If the reporting date of the financial statements of a foreign operation differs from that of the entity and there are no financial data available that match the reporting date of the entity's financial statements, significant changes in exchange rates up to and including the entity's reporting date should be taken into account (DAS 122.309).

If the translation differences relate to a foreign operation that is included in the consolidation, but of which the entity is not a full owner, the cumulative translation differences arising from the translation and attributable to third parties are allocated to, and recognised as part of, non-controlling interests on the consolidated balance sheet.

For further presentation of translation differences, please refer to paragraph 4.7.

An example is given below regarding the method of translation if the presentation currency differs from the functional currency.

Example: Recognition of translation differences in a foreign operation where the presentation currency is not the same as the functional currency

Company A, whose functional currency is the euro, has a participating interest B in Britain that qualifies as a foreign entity. A's share of B's assets at the beginning of the financial year expressed in pounds sterling is GBP 100. A's share of B's profit for the financial year is GBP 50.

The movement of the euro versus pound sterling exchange rate during the financial year was as follows:

Beginning of financial year	GBP 1 = EUR 1.50
Average during the financial year	GBP 1 = EUR 1.75
At year-end	GBP 1 = EUR 2,00

The movement in the value of the participating interest in A's accounts can be shown as follows:

	in GBP	in EUR	
Measurement at the beginning of the financial year	100	150	(= 100 x 1.5)
Profit	50	87.5	(= 50 x 1.75)
Translation difference credited to equity	-	62.5	(= 100 x (2 - 1.5) + 50 x (2 - 1.75))
Measurement at year-end	150	300	(= 150 x 2)

Translation of goodwill paid for a foreign operation
Goodwill arising on the acquisition of a foreign operation is dealt with (DAS 122.310):

a. as an asset or liability (in case of negative goodwill) of the foreign operation, translated at the closing rate; or
b. as an asset or liability (in case of negative goodwill) of the reporting entity expressed in the entity's functional currency, or to be classified as a non-monetary item in foreign currency and recognised at the exchange rate at the time of the transaction.

Example: Translation of goodwill paid for a foreign operation (extracted from appendix to DAS 122)

A BV acquired a 100% interest in associate B (business operations in the United States with USD functional currency) on 1 January. The acquisition price is USD 1,000. The net asset value (based on the fair value of identifiable assets and liabilities and A BV's accounting principles) at 1 January is USD 800. The goodwill is therefore USD 200. At the time of acquisition on 1 January, the exchange rate is USD 1 = EUR 0.80. On 31 December that year, the closing rate was USD 1 = EUR 0.90. For simplicity, it is assumed that there were no changes in net asset value and goodwill during the year. Both the functional and presentation currency of A BV is the euro.

Recognition of exchange differences as at 31 December in accordance with DAS 122.310(a):

Measurement of associate B as at 1 January: USD 1,000 (= USD 800 + USD 200) x 0.80 = EUR 800 (presented as participating interest of EUR 640 and goodwill of EUR 160).

Measurement of associate B as at 31 December: USD 1,000 (USD 800 + USD 200) x 0.90 = EUR 900 (presented as participating interest of EUR 720 and goodwill of EUR 180).

The exchange difference of EUR 100 is recognised directly in a separate item of equity (see paragraph 4.7), and so too is the exchange difference of EUR 20 that arose on goodwill.

Recognition of exchange differences as at 31 December in accordance with DAS 122.310(b):

Measurement of associate B as at 1 January: USD 800 x 0.80 = EUR 640. Measurement of goodwill as at 1 January: USD 200 x 0.80 = EUR 160. Total EUR 800.

Measurement of associate B as at 31 December: USD 800 x 0.90 = EUR 720. The exchange difference of EUR 80 is recognised directly in a separate item of equity (see paragraph 4.7). Measurement of goodwill as at 31 December: USD 200 x 0.80 = EUR 160. Goodwill is measured at the historical exchange rate so no exchange differences are recognised on this.

Translation of 'step-ups' on acquisition
Fair value adjustments to carrying amounts of assets and liabilities ('step-ups') arising on the acquisition of a foreign operation should be translated at the closing rate (DAS 122.310). This means that the entire carrying amount of the relevant assets and liabilities (excluding goodwill) is mandatorily converted at the closing rate.

Previously, it was possible to account for the translation of goodwill and any adjustment to fair value of the carrying amounts of other assets and liabilities of a foreign operation ('step-ups') at the closing rate or exchange rate at the time of the transaction. From financial years commencing on or after 1 January 2020, this option is limited to goodwill. As mentioned in the previous paragraph, adjustments to the fair value of the carrying amounts of other assets and liabilities should be translated at the closing rate on the reporting date. In deviation from Standard 140 'Changes in accounting policies', the change in accounting policy resulting from the expiry of this option may be recognised prospectively. Prospective recognition in this particular situation means that translating the adjustments to the fair value of the carrying amounts of other assets and liabilities at closing rates is only applied to acquisitions occurring in reporting periods beginning on or after 1 January 2020 (DAS 122.602). Fair value adjustments for previous acquisitions then continue to be recognised in accordance with the original accounting policy.

Intra-group receivables or payables
An exchange rate gain or loss relating to an intra-group receivable or payable of the reporting entity cannot be eliminated on consolidation. This is because the relevant receivable or payable entails an obligation for the reporting entity to settle the receivable or payable in foreign currency, which may result in an exchange rate gain or loss for the reporting entity. Therefore, such exchange rate gains and losses are recognised in the consolidated profit and loss account, unless they relate to a net investment in a foreign entity.

Example: Intra-group receivables or payables

Parent company M holds a 100% interest in a subsidiary D. The euro is both M's functional currency and the presentation currency for its company-only and consolidated financial statements. D's functional currency is USD. On 1 June, M lent EUR 100 to D. M's financial year coincides with the calendar year.

The following exchange rates for the year in question are known:

1 June	EUR 1 = USD 1.10
31 December	EUR 1 = USD 1.20

The entry in D on 1 June is as follows:

Bank	USD 110	
Owed to M (IC)		USD 110

On 31 December, the exchange rate loss is recorded in D:

Exchange rate loss	USD 10	
Owed to M (IC)		USD 10

The entry in M on 1 June is as follows:

Receivable from D (IC)	EUR 100	
Bank		EUR 100

Recognition in M's consolidated financial statements
On consolidation, the amount owed by D to M in the amount of USD 120 (= USD 110-USD 10) will be converted at the closing rate (USD 1 = EUR 0.83) to EUR 100. This is eliminated against M's receivable of EUR 100. However, D's exchange rate loss of USD 10 cannot be eliminated in the consolidation. This is justified because D needs euros to meet its liability to M. See also the description in paragraph 4.3.4 and the example therein.

If the loan is not part of the net investment in D, the exchange rate loss of EUR 8.33 (USD 10 / EUR 1.20) should be recognised in M's consolidated profit and loss account.

If the loan does form part of the net investment in D, this exchange rate loss is recognised directly in group equity (foreign currency translation reserve if identified separately*).

Recognition in M's company-only financial statements
In M's company-only financial statements, M will in principle apply the net asset value method to measure the participating interest in D (Article 2:389(1) NCC). The exchange rate loss arising for D is recognised in M's company-only financial statements in the same way as in the consolidated financial statements.

This means that if the loan is not part of the net investment in D, the exchange rate loss is recognised in the company-only profit and loss account, as part of the share in the associate's profit.

If the loan does form part of the net investment in D, the exchange rate loss is recognised directly in equity (foreign currency translation reserve).

In this way, the link between company-only and consolidated equity as well as company-only and consolidated profit or loss is maintained, which is also intended through the applicaton of the net asset value method.

This is summarised below, distinguished by the nature of the intra-group receivable (whether or not part of the net investment in D).

Intra-group receivable is **not** part of net investment in D		
	Consolidated M	*Company-only M*
Exchange rate loss D (EUR 8.33) to be recognised in:	Profit and loss account	Profit and loss account
Intra-group receivable is is part of net investment in D		
	Consolidated M	*Company-only M*
Exchange rate loss D (EUR 8.33) to be recognised in:	Group equity / foreign currency translation reserve if identified separately*	Equity / foreign currency translation reserve

*According to the Decree on annual accounts format (*Besluit Modellen Jaarrekening*, Article 10(3)), the breakdown of equity in the consolidated financial statements is not mandatory.

Sale of a foreign operation
On disposal of a foreign operation, the cumulative amount of translation differences relating to this interest is no longer held in the foreign currency translation reserve. This is because Article 2:389(8) NCC stipulates that in the event of disposal of a foreign operation, the portion relating to the foreign operation is withdrawn from the foreign currency translation reserve. It is therefore not permissible to maintain cumulative exchange differences in the foreign currency translation reserve when the relevant interest has been disposed of. The cumulative amount of translation differences recognised directly in equity (in the foreign currency translation reserve) relating to the foreign operation sold must be recognised in the profit and loss account as part of the gain or loss on the sale of the foreign operation (DAS 122.311). The cumulative amount of translation differences recognised in the profit and loss account is then disclosed separately (Article 2:377(8) NCC).

Partial sale of a foreign operation
In the event of a partial disposal of, for example, a foreign participating interest, Article 2:389(8) NCC stipulates that the part of the reserve that relates to the disposed part of that participating interest should be withdrawn from the reserve. This means that this withdrawn part is recognised in profit or loss as part of the profit or loss on the partial sale of the foreign operation (DAS 122.311).

Write-down is not a sale of a foreign operation
Although the Dutch Accounting Standards Board does not elaborate on this, the (partial) sale of a foreign operation can take place in different ways. IFRS (IAS 21.49) does briefly address this and we consider the guidance on this to be applicable in the light of the legally required insight. A sale can take place by transfer of shares, by a asset/liability transaction or by liquidation. The principle is that the transfer of part of the operation or the termination of the operation creates a gain or loss on disposal in which a proportionate share of the cumulative amount of the foreign currency translation reserve should be included. A write-down or impairment of the assets of a foreign operation *does not* constitute a sale or termination and should therefore not result in a transfer from the foreign currency translation reserve to profit or loss.

4.5 Hedging currency risks

Hedging transactions
A company that transacts in foreign currency or conducts (part of) its business abroad is subject to currency risks caused by the fact that the exchange rate between the functional currency and that foreign currency fluctuates. A company may choose to reduce this currency risk by entering into hedging transactions.

Examples include:

- forward foreign exchange contracts; foreign currencies are bought or sold in the forward market at a fixed forward rate;
- currency swaps; contracts in which parties agree to exchange foreign currency amounts with each other;
- currency options; rights or obligations to deliver or take delivery of a specified amount of currency at a specified exchange rate; the holder of the option has the right to exercise the option but is not obliged to do so; and
- borrowing or lending funds in a foreign currency that mitigates the exchange risk of an opposite currency position; for example, a non-current foreign currency receivable may be matched by a similar loan in the same currency.

Hedging transactions can therefore be achieved through primary financial instruments as well as derivatives. Recognition of hedging transactions is discussed in Chapter 21.

Hedging net investment in a foreign operation
If a loan in a foreign currency has been taken out to finance or hedge the net investment in a foreign operation, the exchange differences arising from the loan should be recognised directly in equity (foreign currency translation reserve) to the extent that they are effective to hedge the exchange differences arising from the net investment in the foreign operation (DAS 122.217).

4.6 Translation in the event of hyperinflation

Hyperinflation occurs if the inflation of the currency has reached 100% or more over a three-year period (DAS 122.312). If a foreign operation whose functional currency is the currency of a hyperinflationary country, an intermediate step must be taken before translation to the presentation currency can take place. The balance sheet and profit and loss account items of the foreign operation should first be expressed in purchasing power units of the foreign operation's functional currency as at the reporting date in order to reflect the impact of price increases. The resulting profit or loss on the net monetary position should be recognised in the profit and loss account and separately disclosed in quantified terms.

The adjusted profit or loss and financial position are then translated to the entity's presentation currency at the closing rate. Resulting translation differences are recognised directly in equity.

Example: Translation to presentation currency in case of hyperinflation

Company A has a subsidiary in Zimbabwe. The subsidiary's functional currency is the Zimbabwean dollar ('ZWD'). Zimbabwe is experiencing hyperinflation. At year-end, A intends to include the Zimbabwean subsidiary's data in its consolidated financial statements. A's functional currency is the euro. When translating the balance sheet and profit and loss account of the Zimbabwean subsidiary, for inclusion in A's consolidated financial statements, the following aspects should be considered:

- the general price index at the beginning of the financial year was 120 and at the end of the financial year 180;
- the average price index for the financial year was 150;
- inventory, as shown on the balance sheet at the end of the financial year, was obtained when the general price index was 170;
- revenues and costs, unlike depreciation based on beginning of financial year, arise evenly over the financial year;
- assets with a historical cost of ZWD 7,500,000 have come to the end of the useful life and have been written off completely. The residual value of ZWD 500 could not be recovered and was recognised as other costs;
- the euro/ZWD translation rate is EUR 1 = ZWD 310 at the end of the financial year.

The translation of the balance sheet and profit and loss account (x 1,000) of the Zimbabwean subsidiary should be as follows:

	1/1	31/12 before adjustment	Indexation factor	31/12 adjusted	Profit or loss on net monetary position	Exchange rate	31/12
	ZWD	ZWD		ZWD			EUR
TFA (cost)	47,500	40,000	180 / 120	60,000	20,000	310	194
Accumulated depreciation TFA	(22,000)	(20,000)	180 / 120	(30,000)	(10,000)	310	(97)
Inventory	-	2,000	180 / 170	2,118	118	310	7
Cash	5,000	10,000		10,000		310	32
Total assets	30,000	32,000		42,118	10,118		136
Shareholders' equity	4,000	4,000	180 / 120	6,000	2,000	310	19
Unappropriated profit	-	2,000		10,118	(1,100)	310	33
Debt	26,000	26,000		26,000		310	84
Total liabilities and equity	30,000	32,000		42,118	900		136
Revenue		50,000	180 / 150	60,000	10,000	310	193
Depreciation		(5,000)	180 / 120	(7,500)	(2,500)	310	(24)
Other costs		(43,000)	180 / 150	(51,600)	(8,600)	310	(166)
Profit on net monetary position		-		9,218		310	30
Profit for the financial year		2,000		10,118	(1,100)		33

The profit on the net monetary position in the adjusted profit and loss account (ZWD 9,218) is the total of the amounts in the column 'Profit or loss on net monetary position':

- the profit on the adjustment ('restatement') of the non-monetary assets and the shareholders' equity ad ZWD 8,118 (= 10,118 - 2,000); and
- the profit on the items in the profit and loss account ad ZWD 1,100 (= 10,000 – 2,500 – 8,600).

The latter amount of ZWD 1,100 has been transferred in the table to the unappropriated profit. So the amount of ZWD 9.218 can also be calculated by summarizing the profit or loss on assets and liabilities (10.118 minus 900).

The items of the balance sheet and profit and loss account in euros are therefore shown in the right-hand column. The carrying amounts of the non-monetary assets, adjusted to the index, and the shareholders' equity ('first restate') are therefore translated at closing rate ('then translate'). The total profit of the financial year (EUR 33) is thus reflected in the unappropriated profit within the equity. The profit on the net monetary position (EUR 30) can be explained by the fact that the company has more debt than monetary assets (cash) over the whole financial year, which has a positive effect in times of (hyper)inflation.

The profit on the net monetary position can also be calculated by determining the weighted average of this net monetary debt during the financial year and dividing it by 180/120. With this factor, the net debt in purchasing power units decreased during the year. In practice, however, the methodology in the table is used because the non-monetary items have to be adjusted to the index anyway and then the profit on the net monetary position can be determined on a net basis.

First year of hyperinflation
The situation where the criteria of hyperinflation are met for the first time is subject to further provisions. In this situation, the initial translation of assets and liabilities of the foreign operation can be done in two ways (DAS 122.312a):

- non-monetary items are translated at the beginning of the financial year for the impact of (hyper)inflation from the dates on which the assets were acquired and the liabilities were incurred. The difference from the previous measurement is recognised in equity; or
- non-monetary items are translated at the beginning of the financial year for the impact of (hyper)inflation from the beginning of the financial year in which the hyperinflation criteria are met for the first time (i.e. at the beginning of the financial year one starts with an index of 100%).

Comparative figures
The comparative figures should be those presented in the relevant previous year's financial statements as figures for the reporting period (regardless of whether hyperinflation occurred in that year) (DAS 122.312). The comparative figures are therefore not adjusted for price and exchange rate changes in the reporting year.

No more hyperinflation
From the moment hyperinflation ceases, the foreign entity's annual figures prepared in local currency no longer need to be adjusted for the impact of price changes before translation. In that case, the inflation-adjusted values, at the time hyperinflation ceases, should continue to be treated as historical acquisition cost for the subsequent translation of the foreign entity's financial statements (DAS 122.313).

4.7 Presentation and disclosure

Presentation of exchange differences in the profit and loss account
There are no specific provisions in the Dutch Accounting Standards regarding the classification of exchange differences in the profit and loss account. The literature identifies three alternatives for presentation:

- the exchange differences are allocated to the underlying transactions and recognised as part of those transactions in the profit and loss account (e.g. in the event of application of hedge accounting; see next paragraph);
- the exchange differences are presented separately as part of operating profit or loss (therefore before financial income and expenses); this method of presentation is only permissible if the transactions underlying the exchange differences are also included in operating profit or loss; and
- exchange differences are recognised as part of financial income and expenses; this alternative is suitable for the presentation of exchange differences arising from transactions not recognised in operating profit or loss.

It is permissible to use more than one alternative for the different 'types' of exchange differences if the nature of the exchange difference justifies it and the method of presentation is applied consistently over time. For example, exchange differences on purchases of goods can be chosen to be presented as part of operating profit or loss while exchange differences on long-term loans are recognised as part of financial income and expenses.

Presentation in the profit and loss account of exchange differences that are hedged
If the currency risk is hedged and hedge accounting is applied, the profit or loss of the hedging instrument and the hedged item must be recognised simultaneously in the profit and loss account (DAS 290.601). This results in a good *matching* of (opposing) profits and losses. The Dutch Accounting Standards Board does not elaborate on the way in which the exchange differences are presented on the hedged item and the opposite profit or loss on the hedging instrument.

In case of cash flow hedge accounting, it is in line with the insight to be provided into the composition of the profit or loss to present the profits and losses on the hedging instrument and the hedged item on the same line in the profit and loss account. The presentation alternatives above can be used as a starting point. So if the currency risk on a purchase transaction of raw materials is hedged and the raw materials are processed in inventories finished product, then it makes sense to present the profit or loss on the hedging instrument on line cost of sales at the time the finished product is sold and thus becomes part of the operating profit or loss. The same applies to the line net revenue if a currency risk on a sale transaction is hedged. In that case, the matching arises because the sales proceeds are recognised at (on balance) the forward rate. After all, the sale transaction results in an effect in the profit and loss account and, on balance, the recognition of net revenue at the forward rate reflects what the revenue in one's own functional currency is.

In case of cost hedge accounting, there are no interim value differences on the hedging instrument, as they remain measured at cost. However, there will be a profit or loss because payments and/or receipts will be made under the hedging instrument, for example at settlement in the case of forward exchange contracts. Therefore, the above paragraph also applies to the presentation of such profits and losses. In the case of a forward foreign exchange contract concluded on a sale transaction, recognition in net revenue can therefore take place in the same way on the basis of the forward rate.

Presentation of translation differences in the company-only financial statements
In the company-only financial statements, translation differences arising from the translation of foreign operations should be recognised in the same way as in the consolidated financial statements (DAS 122.401). That is, in the foreign currency translation reserve. However, the breakdown of equity can be omitted from the consolidated financial statements pursuant to Article 2:411(1) NCC.

Pursuant to Article 2:373(4) NCC, the foreign currency translation reserve (formed pursuant to Article 2:389(8) NCC) is included in equity under the other legal reserves. It is recommended that the foreign currency translation reserve be presented as a separate item in the balance sheet under equity. The alternative is to include the foreign currency translation reserve in the notes as a breakdown of the item Other legal reserves under Equity on the balance sheet.

Article 2:389(8) NCC does not prohibit changing the legal reserve for participating interests (Article 2:389(6) NCC) as a result of changes in the exchange rate of retained earnings and direct equity increases for which that reserve was formed (Explanatory Memorandum to Bill 29 737, no. 3, p. 22). 22).

If the non-distributable foreign currency translation reserve shows a debit balance due to translation losses, this does not imply that this balance should be charged to the profit and loss account. However, the consequence is that free reserves up to the amount of said debit balance are not distributable.

Notes
If there are consolidated financial statements, then for the application of the below mentioned disclosure requirements with regard to the differences between presentation currency and the functional currency, the functional currency of the head of the group should be used (DAS 122.501). This makes sense because the consolidated financial statements itself have no functional currency (consolidated financial statements are only drawn up in a presentation currency) and the comparison must therefore be made with the functional currency of the head of the group to which the consolidation obligation applies.

The principles for the method of translation and recognition of exchange differences should be set out separately for the balance sheet and for the profit and loss account in respect of foreign currency transactions, foreign operations and goodwill and fair value adjustments for the acquisition of a foreign operation (DAS 122.502).

The amounts of translation differences recognised directly in equity and those recognised in the profit and loss account, respectively, should be disclosed in the notes. Translation differences recognised in equity should be shown in the movement schedule of the foreign currency translation reserve (DAS 122.503).

If the presentation currency differs from the local currency (Article 2:362(7) NCC), the reason should be included in the notes. A change in presentation currency should also be explained and justified in the notes (DAS 122.504).

If the presentation currency differs from the functional currency of the reporting entity, this should be disclosed and the reason should be explained (DAS 122.504).

If the functional currency of the entity or a major foreign operation has changed from the previous reporting period, disclose that the functional currency has changed and the reason for this (DAS 122.505).

The notes disclose the impact of a change in exchange rates on foreign currency monetary items or on the financial statements of a foreign operation, if knowledge of this development is necessary for proper review and/or decision-making by users of the financial statements (DAS 122.508).

If the presentation currency differs from the functional currency to which hyperinflation applies, the entity should disclose the closing rates of the presentation currency against the functional currency at reporting date of the financial year and of all previous financial years presented (for comparison) (DAS 122.506).

4.8 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the statutory minimum') in the notes.

4.9 Significant differences from IFRS

Translation of goodwill paid for a foreign operation
IAS 21 requires goodwill paid on the acquisition of a foreign operation to be treated as an asset of the foreign operation (therefore part of the translation of the foreign operation at the exchange rate on the reporting date). DAS 122 *also* allows goodwill paid on the acquisition of a foreign operation to be expressed in the functional currency of the acquiring entity, or to be classified as a non-monetary foreign currency item and recognised at the prevailing exchange rate on the acquisition date. Therefore, if this DAS option is used, the goodwill paid for a foreign operation is no longer subject to currency risk because one-off translation (into the functional currency of the acquiring entity) takes place on the acquisition date.

Hyperinflation
IFRS has a separate standard in IAS 29 for the company-only or consolidated financial statements of an entity domiciled in a hyperinflationary country and where the functional currency is the currency of the country of domicile. The Standards do not have this regulation, which is related to the fact that hyperinflation is not an issue in the Netherlands. Thus, the Standards discuss hyperinflation purely in the context of translation of a foreign operation.

DAS speaks of hyperinflation if there is at least inflation that has totalled 100% or more over a three-year period (DAS 122.213). IFRS does not contain a definition in respect of hyperinflation, but speaks of the following (non-exhaustive) characteristics of the economic situation in the country concerned (IAS 29.3):

- locals prefer non-monetary assets or a relatively stable foreign currency;
- locals designate monetary assets in a relatively stable foreign currency rather than in their own; prices can be displayed in that relatively stable foreign currency;
- sales and purchases on credit include an adjustment for the loss of purchasing power during the credit period, even if that period is short;
- interest rates, salaries and prices are linked to a price index; and
- the cumulative inflation level approaches or exceeds a level of 100% over a three-year period.

The premise of IAS 29 is that non-monetary items are translated from the dates the assets were acquired or the liabilities were incurred at the beginning of the first year of hyperinflation. The DAS provide another alternative that is not allowed under IFRS: non-monetary items are translated for the effect of hyperinflation from the beginning of the financial year (DAS 122.312a). That means starting with an index of 100 at the beginning of the financial year. In the first alternative, the index depends on the time of acquisition of the non-monetary assets and the time of incurring the liabilities, respectively. This alternative can only be used if the criteria for hyperinflation are met for the first time.

IFRS (IAS 29, IFRIC 7) describe the recognition of deferred taxes in the event of hyperinflation. The DAS do not do this. IFRS require deferred tax amounts to be adjusted from the date of acquisition or incurrence of a liability. So in short, this could also affect a period in which hyperinflation had not yet occurred. It is important that the company first makes all adjustments for inflation and only then calculates the deferred tax adjustments. Also, comparative figures, including amounts of deferred taxes, should be adjusted for inflation in accordance with the standard method (IFRIC 7).

Presentation of translation differences in the company-only financial statements
DAS 122 requires translation differences arising from the translation of foreign operations to be recognised in the company-only financial statements in the same way as in the consolidated financial statements (DAS 122.401). A difference between IFRS and NL GAAP now arises if translation differences arise on monetary items included in net investment in foreign operations. IAS 21.33 requires these differences to be recognised in the profit and loss account of the company-only financial statements.

The question arises whether this also applies to the net investment in shares of the foreign participating interest. Here, in IFRS financial statements, participating interests are often measured at cost based on IAS 27.10. In that case, therefore, there are no translation differences related to the asset. But if participating interests are measured solely on the basis of the equity method, the same difference between NL GAAP and IFRS applies in principle. Translation differences resulting from this investment should also be recognised in the company-only profit or loss under IFRS. Differences then naturally arise under IFRS between company-only and consolidated profit or loss, but these differences also arise if consolidated subsidiaries, joint ventures or associates are measured at one of the other alternatives of IAS 27.10 (cost or fair value). In IFRS the notion of (equity/profit or loss) equality between company-only and consolidated financial statements does not come into play.

5 Intangible fixed assets (excluding goodwill)

5.1 Introduction

An intangible fixed asset means an identifiable non-monetary asset without physical form that is used for production, delivery of goods or services, for rental to third parties or for administrative purposes (DAS 210.0). An asset is a resource arising from a past event, over which the entity has control and from which future economic benefits are expected to flow to the entity (see also Chapter 2).

A number of specific issues relating to intangible fixed assets are not addressed in this chapter, namely:

- goodwill (Chapter 6);
- impairments (Chapter 10);
- deferred tax assets (chapter 17);
- the recognition of emission allowances (paragraph 29.7); and
- cost of exploration for oil, gas and other minerals.

DAS 210 does not apply to oil, gas and other mineral exploration costs, assets from insurance contracts, deferred tax assets, assets arising from employee benefit plans and goodwill acquired in a merger or acquisition (DAS 210.101).

5.2 Legal provisions

The balance sheet item Intangible fixed assets should be broken down as follows (Article 2:365(1) NCC):

- costs related to the establishment and issuance of shares;
- development costs;
- acquisition costs relating to concessions, licences and intellectual property rights;
- costs of goodwill acquired from third parties; and
- prepayments on intangible fixed assets.

In the case of capitalisation of development costs and costs related to the establishment and issuance of shares, a legal reserve should be recognised (Article 2:365(2) NCC). The size of this reserve at each reporting date is in principle equal to the carrying amount of the capitalised amount. Paragraph 14.3.8 discusses the legal reserve for capitalised development costs in more detail. Incidentally, the Dutch Accounting Standards Board states that costs related to the establishment and issue of shares do not meet the criteria for capitalisation. The Dutch Accounting Standards include a recommendation not to capitalise these costs (DAS 210.103).

5.3 Recognition

5.3.1 General

Recognition criteria
An intangible fixed asset should be recognised on the balance sheet if (DAS 210.201):

- it is probable that future economic benefits relating to the asset will flow to the entity; and
- the cost of the asset can be determined reliably.

Hence the importance of the probability of future economic benefits and the reliability of the determination of the cost of the asset. This means that a company should estimate the probability of future economic benefits based on reasonable and supportable assumptions. These assumptions will need to reflect management's best estimate of the economic conditions that will exist over the asset's useful life. Moreover, future economic benefits do not exclusively refer to income (e.g. from the sale of goods or services), but also to cost savings resulting from the use of the asset. For example, the use of intellectual property can lead to the limitation of future production costs (DAS 210.116).

Recognition as costs
Not all expenditures to acquire, develop, maintain or improve intangible assets meet the criteria for recognition as an asset. If the expenditures do not meet the mentioned recognition criteria then these should be recognised as costs. The following expenditures may not be capitalised (DAS 210.235):

- start-up costs (including for launching new products or activities; this includes start-up losses);
- expenditures on training activities; and
- expenditures for moving or restructuring (part of) the company.

Expenditures on advertising and promotion (including brochures, mail order catalogues and advertising leaflets) should also not be capitalised (DAS 210.235). These include, for example, expenditures on advertising and promotional material received (see also paragraph 2.4.2). Such expenditures should be recognised as costs at the time of receipt of the promotional material. Expenditures on third-party advertising and promotional services should also not be capitalised. For example, costs of broadcasting commercial messages on radio or television (commercials) or placing advertisements on websites (banners). The costs of this must be recognised in the period when the consideration (broadcasting the commercial or placing the banner) takes place. It is also not permissible to capitalise as part of an intangible asset expenditures that have been recognised as costs in the past (DAS 210.237).

Identifiability
The definition of an intangible fixed asset requires it to be separately identifiable to clearly distinguish it from goodwill (DAS 210.109). This is met if the asset is separable (DAS 210.110). This means that the company can sell, rent, exchange or distribute the specific future economic benefits of the asset separately from future economic benefits associated with other assets. An example of a separable intangible fixed asset is an address database obtained via an acquisition. After all, such an address database can be sold separately.

Incidentally, separability is not a separate condition for identifiability. A company may be able to identify an asset by other means, for example when transferring rights (contractual or other legal rights) as part of a transaction in which other assets have also been acquired.

Example: Identifiability

When recognising identifiable assets as part of a merger or acquisition, it is irrelevant whether the acquiree itself had recognised the asset as such. An example of this is the capitalisation of publishing rights by the acquirer when acquiring a publisher who had built up these publishing rights in-house and had not capitalised them. Numerically, this can be worked out as follows:

Balance sheet of acquiree	D	C
Tangible fixed assets	120	
Receivables	200	
Cash	50	
Equity		160
Provisions		20
Liabilities		190
	370	370

Tangible fixed assets have recently been revalued at fair value. The value of publishing rights accrued but not capitalised by the acquiree is 300.

The acquisition price for the acquiree is 700.

This transaction creates 240 goodwill (= 700 - 160 - 300) instead of 540 (= 700 - 160).

Indeed, publishing rights are identifiable and are therefore capitalised separately, provided of course that the general recognition criteria are met. Apart from tax impacts, the consolidated balance sheet of the acquirer before and after the acquisition is as follows:

Consolidated balance sheet of acquirer (before acquisition)	D	C
Tangible fixed assets	300	
Receivables	250	
Cash	1,000	
Equity		500
Provisions		120
Liabilities		930
	1,550	1,550

Consolidated balance sheet of acquirer (post-acquisition)	D	C
Publishing rights	300	
Goodwill	240	
Tangible fixed assets	420	
Receivables	450	
Cash	350	
Equity		500
Provisions		140
Liabilities		1,120
	1,760	1,760

Control
As mentioned earlier, control is a prerequisite for capitalisation. Especially for intangible fixed assets, having control can be difficult to determine. In general terms, a company can be said to have control if it is able to dispose of the future economic benefits of the asset and also shield them from third parties (DAS 210.112). Often, this lies in the (legally) enforceable right to have the economic benefits of the asset flow to the company. One example is the legal protection of knowledge, including through copyrights, patent rights and confidentiality obligations.

This enforceable right is usually absent from the workforce, which generally represents a very important intangible value for the company. However, due to the relatively short notice periods of staff members, it is usually not possible to exercise *control* over the staff. An exception exists for contracts occurring in the culture, sports and recreation sector where transfer fees are paid to the staff member's previous contracting party to secure a staff member's long-term contract. As often happens, for example, in transfers between professional football clubs. In that case, the transfer fee is seen as the cost of a contract to bind a footballer to the club for a longer period of time. The transfer fee is not paid to the footballer themselves but to the club where the footballer was under contract. The new contract prevents other clubs from having the footballer's skills at their disposal during the contract period. Thus, the intangible fixed asset is not the staff member themselves, but the contract with that staff member. On initial recognition of this contract, the acquisition cost is the basis for initial measurement.

The lack of control over staff is also a reason why, for example, expenditures on training are excluded for capitalisation. When staff leave, the company also no longer has control over the knowledge of the staff concerned (DAS 210.114). On top of this, it will generally not be possible to reliably measure accumulated knowledge.

Another example where control may be lacking is when software is made available through a subscription to IT services via the cloud and the internet. In this case, we speak of *software-as-a-service* (SAAS) provided to the company by the cloud provider (also called the application service provider (ASP)). Under this type of service contract, the source code of the software is generally not owned by the entity but by the cloud provider, which also maintains the software and protects it through a protective wall (firewall). Thus, in such a SAAS contract, there is no control over an identifiable asset (software) but a service whose costs must be recognised in the period in which the service is provided.

SAAS contracts take various forms, and while there will usually be rendering of services, the possibility of an identifiable intangible asset cannot be entirely ruled out either. In our opinion, an intangible fixed asset exists if the following conditions are met:

- the company has the right to dispose of the source code of the software during the contract period without paying a significant penalty for it; and
- the company can either exploit the software on its own servers or have it managed ('hosted') by another party (independent of the original SAAS provider). The latter form, incidentally, refers to a *platform-as-a-service* (PAAS) rather than SAAS.

Example: A SAAS subscription to an ERP system

A company enters into a SAAS subscription to use an online enterprise resource planning (ERP) package in which the software is provided and maintained by the SAAS provider and all data in the cloud is managed and secured by this provider. There is no question of the company having control over the (source) code of the ERP software itself (even on a temporary basis during the contract period). The company pays 20 million (initial fee) at the beginning of the five-year contract period, while a fixed maintenance and management fee of 500,000 is payable each year.

In this case, the company has the right to be provided with a service for five years. However, the agreement does not lead to control over an identifiable asset. Nor is it a lease, because power over the software provided cannot be exercised on a temporary basis, i.e. during the contract period, either. There is therefore no transfer of the right to use identifiable assets. For these reasons, the company will have to recognise the amounts payable as costs of rendering of services. These costs should be spread over the service period. Assuming that the benefits of this service will accrue equally to the company during the contract period, 4 million in initial fee is allocated to each year. The initial fee itself should be considered a prepaid amount to be capitalised (DAS 224). Given the long-term nature of the service and the generally material amount of the initial fee, in line with DAS 224.102, we consider classification under intangible fixed assets best serves the insight requirement, including insight into the company's liquidity and, in particular, working capital. Indeed, DAS 224.102 prescribes that the character of prepayments and accrued income should be expressed on the basis of the insight requirement either by classification on the balance sheet, by specific designation or by further explanation in the notes. Based on Article 7(2) of the Decree on annual accounts format (BMJ), an item can be inserted in the balance sheet in the breakdown of intangible fixed assets for the prepayments on the specifically mentioned ERP service. We note that this situation involves allocating a prepaid item to the correct period for determination of profit or loss, so that in a profit and loss account by nature of expense these costs are presented under other operating expenses rather than under amortisation expenses. The annual fixed maintenance and management fee is recognised over the year if the benefits of the service are enjoyed proportionately over the year, which will generally be the case.

5.3.2 Internally generated intangible fixed assets

General

The Dutch Accounting Standards have only limited possibilities to recognise internally generated intangible fixed assets. For instance, the recognition of internally generated trade marks, logos, publishing rights, customer databases and similar items is excluded (DAS 210.229). This is based on the assumption that these are not easily identifiable assets because they cannot be distinguished from the costs of developing the business as such (DAS 210.230). Furthermore, in many cases the company has no control and the cost cannot be reliably determined (DAS 210.217).

Research and development expenditures

It is precisely the issues surrounding identifiability, potential future economic benefits and the cost that make it complex to determine whether an internally generated intangible asset meets the criteria for capitalisation. Partly for these reasons, DAS 210 makes the following division between stages (DAS 210.219):

- research stage; and
- development stage.

The above is in line with Article 2:365(1) NCC. That article stipulates that only development costs are eligible for capitalisation.

Research stage

Research is defined as the innovative and planned research work with the aim of developing new scientific knowledge and insights (DAS 210.0). Research expenditures cannot be capitalised and should be recognised directly in the profit and loss account (DAS 210.221). The general principle is that a company cannot demonstrate at the research stage that an intangible fixed asset has been created that will probably generate future economic benefits (DAS 210.222).

The uncertainty regarding future economic benefits is evident from the following examples of research activities: seeking alternatives to materials, production methods, automated systems and seeking new knowledge and applying research results.

Development stage
Development is defined as the application of knowledge obtained by research or otherwise, leading to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services, prior to the commencement of commercial production or use (DAS 210.0). This could include the following activities: building and testing prototypes, designing tools and moulds and building test rigs for production.

The description shows the increasing degree of specificity compared to the definition of research. Terms like 'application of knowledge' and 'commercial production or use' indicate this. Nevertheless, this still does not provide sufficient support to capitalise expenditures during the development stage. Capitalisation is therefore only permitted, but also mandatory, if the company can demonstrate all of the following (DAS 210.224):

- the technical feasibility of completing the intangible fixed asset so that it will be available for use or sale;
- the intention to complete the intangible fixed asset and use or sell it;
- the ability to use or sell the intangible fixed asset;
- how the intangible fixed asset will probably generate future economic benefits;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible fixed asset; and
- the ability to determine reliably the expenditure during the development of the intangible fixed asset.

Only from the moment all these conditions are met should development costs be capitalised. Capitalising previously incurred development costs is not permitted (DAS 210.237).

Also included in DAS 210.224 is an explanation of how a company can demonstrate that an intangible fixed asset will generate future economic benefits. One possibility is for the company to demonstrate that a market exists for the goods or services generated by the intangible fixed asset. Alternatively, the company could demonstrate that a market exists for the intangible fixed asset itself or demonstrate the usefulness of the intangible fixed asset if the intangible fixed asset is used within the company. The fact that an intangible fixed asset is used also means, normally, that the asset generates economic benefits. The numerical substantiation of the expected future economic benefits should be done in the same way as the substantiation of the budgeted cash flows, as takes place when calculating impairments (DAS 210.226). See also Chapter 10.

For example, the availability of adequate resources for the completion and use of an intangible fixed asset can be demonstrated by a business plan. In certain cases, the entity may demonstrate the availability of external financing by a proposal from a financier offered for that purpose (DAS 210.227).

The cost of internally generated intangible fixed assets can usually be reliably determined from internal cost records, such as records of staff costs and hours (DAS 210.228). Finally, a legal reserve should be included, in the amount of the capitalised development costs (Article 2:365(2) NCC).

Website costs
A company's website is an example of an internally generated intangible fixed asset. Therefore, any capitalisation and measurement should be in line with the relevant rules, including, of course, the division between the research and development stage. A specific consideration with regard to the development phase is the substantiation of the potential to realise future economic benefits. Expenditures on websites developed solely for promoting the company or its products and services are not eligible for capitalisation. Capitalisation is only permitted if the website can generate revenues, for example through placing orders or selling advertising space to third parties. Only in such a situation will the general capitalisation criteria also be met.

Given the specific nature of website development, an appendix to DAS 210 elaborates on the different stages of website development. This also indicates the prescribed recognition. Incidentally, the expected economic life of a website is usually short.

The table below lists the options for recognition.

Recognition as an asset	Recognition as expense
Graphic design development.	Planning, such as feasibility study, defining hardware and software specifications.
Application and infrastructure development, such as hardware procurement and software development.	Exploitation, such as updating graphics and content. If the conditions in paragraph 5.3.4 are met, capitalisation is possible.
Content development, such as creating, sourcing and preparing information (other than for advertising and promoting an entity's own products and services).	Other, such as administration, sales and general costs and content developed for advertising and promoting products and services, such as photos of products.

5.3.3 Configuration and customisation costs when implementing SAAS contracts

Paragraph 5.3.1 discussed software-as-a-service (SAAS) contracts. In addition to the costs of the SAAS contract, companies often incur costs to configure the SAAS application according to specific requirements and security protocols (e.g. access rights). Costs are also incurred to make existing software systems and applications communicate with the SAAS application provided by the SAAS supplier. The specific software developed to enable data communication between different applications is usually called an *application programming interface* (API). The question that arises is how such costs for configuration and customisation should be recognised by the company buying the SAAS system. For this purpose, it must first be ascertained whether the company acquires an intangible fixed asset. In our view, the key to answering this question lies first of all in whether the company has the software code for the APIs themselves. If so, then it is an identifiable intangible asset because the code is distinguishable as such and can be shielded. Assuming that the benefits of the APIs are demonstrable during the SAAS contract period, an amortisation period equal to the duration of the SAAS contract is self-evident.

It is also possible that the SAAS service provider will build the APIs and then manage and secure them itself through its own access security systems (firewalls). In that case, the company does not acquire an intangible fixed asset. The APIs, together with the SAAS contract (e.g. the ERP system mentioned in the example of paragraph 5.3.1), can then be seen as a combined service, because in addition to the rendering of services in respect of SAAS, communication with existing systems is also achieved. Even then, it is logical for the company to allocate the costs of building the APIs to the SAAS contract period, even if the expenditures are incurred at the beginning of the contract period. The expenditures can then be recognised as part of the prepaid amount to be capitalised in the example given in paragraph 5.3.1.

Finally, building the APIs – in order to communicate with the SAAS system – may be a clearly separate service performed by the SAAS provider or by third parties. In this situation, the source code remains with the supplier. So the service actually involves providing a working solution during the term of the SAAS contract to allow existing systems to communicate with the SAAS application. Next, assume that the expenditures for this are mainly incurred at the beginning of the contract period, during or just after building the APIs. For recognition in the company's financial statements, there are then effectively two options:

1. costs are recognised in the profit and loss account at the time the services are received, i.e. during development or, at the latest, after completion of the APIs; or
2. costs are spread over the duration of the SAAS contract period.

We consider both options acceptable. Of course, the second option should involve the company reaping benefits during the SAAS contract period by connecting the existing system with the SAAS application. Benefits that would also have been obtained if the code were managed and secured by the company itself. In that case, it is logical to also treat these expenditures as prepaid and therefore prepayments and accrued income (DAS 224), as they are linked to the benefits that can be achieved during the SAAS contract period. Given the long-term nature of the service and the generally material amount of these expenditures, in line with DAS 224.102, we consider classification under intangible fixed assets best serves the insight requirement. This is based on the same considerations as mentioned in the example in paragraph 5.3.1 regarding the classification of the prepaid initial fee on conclusion of a SAAS contract. We note that this situation involves allocating a prepaid item to the correct period for determination of profit or loss, so that in a profit and loss account by nature of expense these costs are classified as other operating expenses rather than amortisation expenses. The way the APIs are built (integrated or not) and the party building the APIs (SAAS supplier or third party) will then no longer matter for the recognition of these costs of rendering of services. This recognition method is different from IFRS. We refer to the last paragraph of this chapter for this.

5.3.4 Subsequent expenditures

After initial capitalisation, additional expenditures of a purchased or self-developed asset should be recognised as costs. The exception is where both conditions below are met (DAS 210.303):

- the expenditures will probably lead to an increase in expected economic benefits; and
- the expenditures can be reliably determined and attributed to the asset.

However, this situation will occur only in exceptional cases. Indeed, it is extremely difficult to determine whether subsequent expenditures lead to an increase or maintenance of the original level of performance. Maintenance expenditures should be recognised as an expense. In addition, it will often be difficult to reliably attribute such expenditures to an individual asset (DAS 210.304).

Example: Licence registration fee

A company has successfully developed a patent from which benefits will probably flow. The costs of the patent are capitalised during the development stage from the moment the conditions for capitalisation were met (DAS 210.224). The asset is then amortised from the time the patent is applied. The initial cost of registering the patent in the European register is recognised as part of capitalised costs. Each year, entry in the register must be renewed, for which annual registration fees must be paid. If the company no longer needs the patent, it will no longer opt for renewal in the register and, of course, the renewal fee will no longer have to be paid. The company is expected to opt for the renewals during the expected useful life of the patent (five years).

Renewal costs are subsequent expenditures and should be recognised as costs. They do not increase the expected benefits flowing from an asset but ensure that the patent is and remains registered so that patent law applies and any infringements can be fought under that law.

5.4 Measurement

Introduction
Intangible fixed assets can be measured at cost (acquisition or development cost) or current value from the moment the criteria for capitalisation are met (Article 2:384(1) NCC). At the heart of the choice of measurement are the provisions of Articles 362(1) to (4) NCC (Article 2:384(1) NCC). Measurement at current value of intangible fixed assets is only possible if there is a active market (Article 6 BAW). Goodwill and prepayments on intangible fixed assets can only be recognised under Article 2:385(4) NCC up to a maximum of the expenditures incurred for them, less amortisations.

5.4.1 Purchase and development cost

General
The purchase or development cost includes the purchase price including all directly attributable expenditures to make the asset fit for its intended use (DAS 210.204). This may include consultancy fees for software implementation and legal advisory fees. In the case of internally developed intangible fixed assets, these expenditures may also include attributable expenditures on materials and services, wage, salary, and other staff costs and 'direct' overheads, e.g. depreciation of machinery and property (DAS 210.232). A number of expenditures are not part of the development cost, such as 'indirect' overheads (selling and administrative costs), inefficiency and start-up losses as well as staff training costs (DAS 210.233).

If a longer than normal credit period is stipulated for the payment of the purchase price, the purchase cost is set at present value (DAS 210.205). The difference between nominal and present value is then recognised as borrowing costs in the period for which the payment is deferred. An exception to expensing to profit or loss is where the borrowing costs may be capitalised. For an explanation of this, see paragraph 7.3.1.

Acquisition by merger or acquisition
When intangible fixed assets are acquired in a merger or acquisition, the purchase cost is the fair value of the relevant assets at the time of acquisition. As a result of a merger or acquisition, an intangible fixed asset may be capitalised on the acquirer's side, while it has not been capitalised on the acquiree's side. An example is given in paragraph 5.3.1.

In particular, the reliable determination of this fair value (or cost) can be complex. Starting points could be prices of recent and similar transactions. It may also be possible to determine fair value by discounting estimated future cash flows (DAS 210.210). If the fair value cannot be measured reliably, the asset may not be capitalised separately. Recognition then takes place as part of goodwill. Unless there is an active market for an intangible fixed asset purchased in a merger or acquisition, the initial measurement of the intangible fixed asset is at most the amount above which negative goodwill would arise or increase (DAS 210.212).

Exchange
It is possible to acquire an intangible fixed asset through exchange transactions, where the following two situations may arise:

- non-equivalent exchange: the intangible fixed asset is acquired through an exchange with a dissimilar other (intangible) asset;
- equivalent exchange: the intangible fixed asset is acquired in exchange for a similar asset used in the same way for the same activities and where the fair value is also equivalent.

With a non-equivalent exchange the cost of the asset acquired is the fair value of that asset (DAS 210.214). This value is set at the fair value of the sacrificed asset adjusted by any additional payment or receipt of cash. The difference between the carrying amount and the fair value of the sacrificed asset leads to the entry of a profit or loss.

Example: Non-equivalent exchange

An art gallery acquires commercial broadcasting rights in exchange for paintings. If the paintings have a carrying amount of 2,500 and a fair value of 3,500, the broadcasting rights should be capitalised for an amount of 3,500. The transaction thus leads to a profit for the art gallery of 1,000. This should be recognised as a transaction with a revenue of 3,500 and a cost of 2,500 in accordance with the provisions of Chapter 26.

In the case of an equivalent exchange, the purchase cost is equated to the carrying amount of the transferred asset (DAS 210.215). In principle, no profit or loss is therefore recognised in such an exchange. However, the fair value of the purchased asset may be significantly lower than the carrying amount of the transferred asset. This difference may show that the transferred asset is subject to impairment. If so, such impairment is recognised in profit or loss. The purchase cost is then the carrying amount of the transferred asset after deducting the impairment.

Government grants
In some cases, through an obtained government grant an intangible fixed asset can be acquired for free or at a very low price. Examples of such transactions include the allocation or sale to an entity (usually by a government agency) of radio and TV broadcasting licences, landing rights and import licences or quotas or access rights to scarce resources. For recognition of the intangible fixed asset and the grant in these situations, see Chapter 29. Also refer to Chapter 29 for the recognition of a development loan obtained to finance development costs.

5.4.2 Current value

General
The law allows intangible fixed assets to be measured at purchase or development cost and current value (Article 2:384(1) NCC). Applying current value measurement to intangible fixed assets is subject to conditions. Costs of goodwill acquired from third parties and prepayments on intangible fixed assets may not be measured at current value (Art. 2:385(4) NCC).

Intangible fixed assets other than those mentioned in the previous sentence may be valued at current value only if (Article 6 BAW):

- the asset was recognised on the balance sheet at cost from the time of acquisition (this refers to the initial measurement at acquisition); and
- a liquid market exists for the asset.

The first condition implies that internally developed intangible fixed assets that have not been immediately capitalised cannot be subsequently recognised at current value. A liquid market exists if the assets concerned are homogeneous, willing buyers and sellers can be found at any time and transaction prices are publicly known. For intangible fixed assets, a liquid market will usually not exist.

For intangible fixed assets that are not held as investments and are measured at current value, current cost applies (Article 7 BAW).

Impairments
If after initial recognition an intangible fixed asset is measured according to the current value model, the asset is measured at the lower of (1) current cost and (2) the higher of value in use and net selling price (DAS 210.306). See also Chapter 10.

Revaluation reserve
If intangible fixed assets, other than investments, are measured at current value, the value increase must be included in a revaluation reserve (Art. 2:390(1) NCC). See also Chapter 14.

5.5 Amortisation and impairment

Amortisation period
Amortisation of intangible fixed assets should be systematic based on their estimated economic lives (DAS 210.401). There is a rebuttable presumption that this economic life is a maximum of 20 years from the time the asset is ready for use. This is also when amortisation should start. Only in exceptional cases will the maximum life presumption be rebuttable. If a life of more than 20 years is assumed, there is an obligation to estimate the recoverable amount annually to recognise any impairment (DAS 210.406). For a discussion on impairments, see Chapter 10. In addition to this general rule, Article 2:386(3) NCC stipulates that costs of establishment and costs of issuing shares must be amortised over a maximum of five years.

In exceptional cases where the useful life of capitalised development costs cannot be reliably estimated, these costs are amortised over a period not exceeding 10 years (Article 2:386(3) NCC).

Many factors come into play in determining the life of an intangible fixed asset, including (DAS 210.404):

- the expected use of the asset;
- the specific life cycle of the asset;
- (technological) obsolescence;
- the stability of the relevant industry and changes in demand for the products or services generated with the asset;
- the expected behaviour of competitors or potential competitors;
- the required maintenance expenditures and the company's ability and intention to achieve the required level;
- dependence on the life of other assets; and
- the period during which the entity can dispose of the asset as well as legal and other restrictions on the use of the asset.

In certain situations, it is acceptable to estimate the life of an asset beyond the period for which the legally enforceable right to dispose of the asset (e.g. the term of a patent) applies. This requires that the right can be extended and that this extension is virtually certain. An indication for this is that it can be shown that the conditions for extending the right are met.

An annual review of the economic life is required for all intangible fixed assets (DAS 210.416). Any change in life is treated as a change in accounting estimates (DAS 145.101). The recognition of these is set out in Chapter 3.

If, as a result of a life extension, the economic life, counted from the moment of commissioning, still exceeds 20 years, then the annual valuation requirements to determine impairment and the requirements for more comprehensive disclosures still apply.

Amortisation method
The amortisation method used should be consistent with the pattern in which the economic benefits generated by the asset flow to the entity. If this pattern cannot be reliably determined, the straight-line method should be used (DAS 210.411).

A selected amortisation method is applied systematically over its entire life unless there is a change in the pattern in which the economic benefits flow to the entity. The amortisation method used should be reviewed annually (DAS 210.416). If, based on this review, it is necessary to change to a different amortisation method, this is classified as a change in accounting estimates (DAS 145.201). See also Chapter 3.

In exceptional cases, an intangible fixed asset may be assigned a residual value. Conditions for this are (DAS 210.413):

- the commitment by a third party to purchase the asset at the end of its economic life; or
- an active market for the asset, where the residual value can be determined on the basis of market data and, in addition, it is probable that there will still be an active market for the asset at the end of its economic life.

In determining the residual value, the price level of a similar asset that is at the end of its economic life and has operated under similar conditions to those under which the new asset will operate is relevant. The residual value may not be increased by expected price increases (DAS 210.415).

Impairments
Article 2:387 NCC stipulates that an impairment must be taken into account if it is expected to be permanent. An impairment should be recognised as a charge to profit or loss. For three categories of intangible fixed assets, the recoverable amount of the asset should be determined annually, regardless of the existence of indications of impairment. This concerns intangible fixed assets not yet put into use and intangible fixed assets with a life of more than 20 years (DAS 210.419). Such a calculation should also be made for intangible fixed assets that have been taken out of use (DAS 210.426).

For further information on impairments, refer to Chapter 10.

Retirement
An intangible fixed asset measured at cost and taken out of use should be measured at its carrying amount at the time of retirement (DAS 210.426). However, in the event of retirement, the company should, at least at the end of each financial year, determine the recoverable amount and test for impairment.

If an intangible fixed asset is no longer expected to generate future economic benefits, the asset may no longer be capitalised. This is because one of the capitalisation criteria (DAS 210.423) is no longer met. The profit or loss of the retirement is recognised in the profit and loss account. The amount of the profit or loss consists of the difference between the carrying amount and the net revenue from the asset (DAS 210.424).

5.6 Presentation and disclosure

Presentation
Paragraph 5.2 explains the different (non-exhaustive) categories of intangible fixed assets. A further breakdown is included if it provides relevant information. This involves clustering assets that are similar in nature and function for the entity. An example is the separate disclosure of (purchased) publishing rights with a publisher.

When classifying software, classification as an intangible or tangible fixed asset is a consideration. Such classification depends on the nature of the software in relation to any tangible asset to which it is related (DAS 210.107). If the tangible component predominates, the software is recognised as part of this tangible fixed asset. An example might be specific control systems for production machines. Such software has no value without the related tangible fixed asset (the production machine). If software can be named separately, such as a payroll or financial package, then it is recognised as an intangible fixed asset.

Disclosure
The following should be disclosed in the notes, split between internally developed and other intangible fixed assets (DAS 210.501):

- the accounting principles for determining the cost and/or current value;
- the economic life or the amortisation percentages used;
- the amortisation methods used;
- historical cost and accumulated amortisation (including impairments) at the beginning and end of the financial year;
- the item in the profit and loss account that includes the amortisation of intangible fixed assets;
- a reconciliation between the carrying amount at the beginning and end of the financial year, showing the following movements separately (movement schedule):
    - investments, showing internally developed assets and assets acquired on acquisition separately;
    - retirements and disposals;
    - revaluations, if the current value model is applied;
    - impairments of fixed assets;
    - reversals of impairments;
    - amortisation;
    - currency translation differences;
    - other movements in carrying amount.

The Dutch Accounting Standards Board recommends including comparative figures from the previous financial year in the movement schedule if this is important for understanding the relevant item (DAS 110.127). For each item included in intangible fixed assets measured at current value, the sum of revaluations as at the reporting date should be disclosed (Article 2:368(2) NCC). Article 9 BAW further requires that where measurement is at current value, the notes should explain how the current cost, value in use or net selling price was determined.

In addition, the following disclosure requirements apply to the specific situations below (DAS 210.504 and 505):

- The nature and impact of any changes in the accounting estimates used. Chapter 3 elaborates on this.
- If the amortisation period of an intangible fixed asset exceeds 20 years, the reason why the maximum life assumption of 20 years is rebutted, is explained. This disclosure also includes the factors that played a significant role in determining the asset's life.
- The description, carrying amount and remaining useful life of each individual intangible fixed asset that is an item of significant interest to the entity.
- The carrying amount of intangible fixed assets with restricted property rights and the carrying amount of intangible fixed assets pledged as security for debt.
- Liabilities arising from the acquisition of intangible fixed assets.

To the extent that an entity capitalises development costs and costs related to the creation and issuance of shares, it must explain them (Article 2:365(2) NCC). For research and development costs, in addition, the financial statements should show the total research and development costs charged to profit or loss for the financial year, including amortisation of previously capitalised development costs (DAS 210.506).

Finally, it is recommended that the following information be included in the financial statements (DAS 210.508):

- a description of fully amortised intangible fixed assets still in use;
- a brief description of significant intangible fixed assets not recognised on the balance sheet because the capitalisation criteria were not met.

5.7 Exemptions for medium-sized and small entities

Medium-sized and small legal entities are exempt from the distinction to be made between internally generated intangible fixed assets and other intangible fixed assets (DAS 210.501). In addition, small legal entities are exempt from the breakdown of the categories of intangible fixed assets (DAS 210.501) under Article 2:396 NCC, with the exception of the separate disclosure of capitalised costs related to the establishment and issue of shares (Article 2:396(3) NCC).

Furthermore, small legal entities are exempt from the requirement to capitalise intangible fixed assets arising from development if all the criteria of DAS 210.224 are met, unless internal development of intangible fixed assets is part of the entity's principal activity (DASsmall B1.105).

Small legal entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the 'legal minimum') in the notes.

5.8 Significant differences from IFRS

Amortisation of intangible fixed assets
Under IAS 38 'Intangible Assets', a distinction is made between intangible fixed assets with finite useful lives and intangible fixed assets with indefinite useful lives. If an intangible fixed asset is expected to have an indefinite useful life, IAS 38 does not permit such an asset to be amortised annually. However, in each reporting period, facts and circumstances should be used to determine whether the initial assumption regarding the indefinite useful life is still valid. An explanation of the factors contributing to the indefinite useful life expectancy is also required. Intangible assets with finite useful lives should be amortised systematically over their useful lives. Under DAS 210, all intangible fixed assets have a determinable useful life. As a result, all intangible fixed assets should be amortised on a systematic basis. According to DAS 210, there is a rebuttable presumption that the useful life of an intangible fixed asset is a maximum of 20 years.

Indications of permanent impairment in intangible assets
If the expected finite useful life is longer than 20 years, IAS 38 only requires the recoverable amount to be determined if there are indications of impairment. DAS 210 states that in such a case, the recoverable amount should be determined at the end of each financial year, even if there are no indications of impairment.

For intangible assets that, under IAS 38, are expected to have an indefinite useful life and as a result are not amortised annually, the recoverable amount must be determined annually even if there is no indication of impairment.

Costs related to the issuance of equity instruments
According to IAS 38 'Financial instruments: presentation', costs related to the issue of equity instruments should be recognised in equity. DAS 210.103 and DAS 240.219 recommend this recognition method only because Dutch law allows capitalisation of these costs (Art. 2:365(1) NCC).

Configuration and customisation costs when implementing SAAS contracts
The IASB's interpretation committee (IFRIC) issued a pronouncement in April 2021 to the effect that the cost of 'configuration and customisation services' in the implementation of SAAS contracts should, in certain situations, be recognised when the specific services are received. This particularly concerns the situation where the rendering of services is clearly distinguishable from SAAS services. As discussed in paragraph 5.3.3, we also consider it acceptable under NL GAAP, subject to conditions, to spread these costs over the period in which the benefits of the SAAS contract are enjoyed.

Recognition of acquired intangible assets through acquisition or merger
DAS 216 'Business Combinations' states that in the case of an acquisition, identifiable intangible assets should be recognised if:

- it is probable that future benefits will flow to the acquirer (also known as the probability criterion); and
- fair value can be measured reliably.

IFRS 3 ‘Business combinations’ states that identifiable intangible assets must be recognised separately on acquisition. Under IFRS, it is assumed not only that the probability criterion is always met for identifiable intangible assets, but also that sufficient information is present to reliably determine the fair value of identifiable intangible assets (IAS 38.33). See also Chapter 31.

6 Goodwill

6.1 Introduction

According to Article 2:365(1) NCC, positive goodwill is an intangible fixed asset. Based on the definition of an intangible fixed asset as included and elaborated in DAS 210, strictly speaking goodwill is not an intangible fixed asset. This is because an intangible fixed asset is an identifiable non-monetary asset without physical substance that is used for production, delivery of goods or services, for rental to third parties or for administrative purposes (DAS 210.0). This definition of an intangible fixed asset requires the existence of an identifiable asset to clearly distinguish it from goodwill. An intangible fixed asset can be clearly distinguished from goodwill if the asset is separable, i.e. if the entity can rent, sell, exchange or distribute the specific future economic benefits of the asset separately from the future economic benefits associated with other assets in the same revenue-generating activity. This is not the case with goodwill.

Positive goodwill arises if the consideration exceeds the initial measurement of the participating interest acquired. This initial measurement is the balance of the fair values of the identifiable assets and liabilities on the acquisition date. Positive goodwill may result from synergy effects that bring expected economic benefits. Goodwill may also arise from assets that do not qualify for recognition in the balance sheet on their own, but for which the acquirer is willing to pay as part of the acquisition.

In addition to positive goodwill, there may also be negative goodwill. Negative goodwill arises if the balance of the fair values of the identifiable assets and liabilities exceeds the consideration on the acquisition date. Negative goodwill may offset expected future losses and expenses. Negative goodwill could also simply be the result of a "lucky buy".

Chapter 31 discusses in more detail how to determine the acquisition date and how to determine the amount of the acquisition cost and the fair values of the identifiable assets and liabilities. That chapter applies primarily to acquisitions. The discussion in Chapter 31 also applies to the initial recognition of the acquisition of participating interests over which significant influence is exercised and joint ventures under joint control, which are measured at net asset value.

In some cases, expenditures are incurred to generate future economic benefits that do not meet the criteria for recognition of an intangible fixed asset as set out in DAS 210. Such expenses are often regarded as a contribution to the internally generated goodwill. Internally generated goodwill cannot be recognised as a separate asset because it is not an identifiable asset over which the entity has power of disposal and whose acquisition or construction cost can be reliably determined (DAS 210.217). Internally generated goodwill must therefore not be capitalised (DAS 210.216).

This chapter discusses positive and negative goodwill arising from an acquisition. See Chapter 5 for the treatment of other types of intangible fixed assets.

6.2 Positive goodwill in an acquisition

6.2.1 Recognition and measurement

The positive difference between the acquisition cost and the acquirer's share of the fair values of the identifiable assets and liabilities acquired at the time of the transaction is referred to as "positive goodwill" (hereinafter referred to as "goodwill").

Recognition of goodwill
Recognising (Article 2:389(7) NCC) and amortising goodwill according to its expected useful life (Article 2:386(3) NCC) is mandatory. For financial years starting from 2016, it is no longer permitted by law to charge goodwill as a result of acquisitions taking place on or after 1 January 2016 (1) directly to equity or (2) as a lump sum to the profit and loss account. This was possible for acquisitions occurring before that date.

The following points are also provided by law:

- if, in exceptional cases, the expected economic life of goodwill cannot be estimated reliably, goodwill is amortised over a maximum period of ten years (Article 2:386(3) NCC); and
- amortisation of goodwill may not subsequently be reversed (Article 2:387(5) NCC).

Any adjustment to the amortisation period is a change in accounting estimates that must be recognised prospectively (DAS 145.101).

Measurement of goodwill
Goodwill is measured at the amount recognised at initial recognition less accumulated amortisation (see paragraph 6.2.2) and any impairment losses (see paragraph 6.2.3) (DAS 216.218).

Measurement of goodwill in the company-only financial statements on acquisition of a participating interest with a negative net asset value
If, on acquisition, the value of a participating interest on a net asset value basis is negative, the amount of goodwill in the company-only financial statements depends on whether the entity fully or partially guarantees the associate's debts or has a constructive obligation to enable the associate to pay its debts (DAS 214.333a).

For example, if the entity does not guarantee the participating interest's debts, the goodwill is equal to the acquisition cost. If the entity does fully or partially guarantee the associate's debts, the goodwill is the sum of the acquisition cost and the estimated liability. The example describing the acquisition of a participating interest with negative equity in paragraph 9.2.6 illustrates this.

The basic principles included above may cause the goodwill in the company-only financial statements to differ from the goodwill in the consolidated financial statements. If this is the case, equity and the profit or loss according to the company-only and consolidated financial statements will also differ. This discrepancy is caused by the fact that in the consolidated financial statements, the goodwill is equal to the sum of the acquisition cost and the negative net asset value rather than the sum of the acquisition cost and the estimated liability arising from guaranteeing the associate's debts.

Foreign currency
Goodwill paid on the acquisition of a foreign operation is treated as (DAS 122.310):

- an asset or liability (in the event of negative goodwill) of the foreign operation, to be converted at the exchange rate on the reporting date; or
- an asset or liability (in the event of negative goodwill) of the reporting entity expressed in the entity's functional currency, or to be classified as a non-monetary item in foreign currency, and to be recognised at the exchange rate applicable at the time of the transaction.

See Chapter 4 for a detailed discussion of the recognition of foreign currency items or transactions.

6.2.2 Amortisation

Rationale for goodwill amortisation
Capitalised goodwill must be amortised on a consistent basis over its expected useful life (Article 2:386(3) NCC). The Dutch Accounting Standards use the term "economic life" instead of "useful life". In a situation where the future earnings potential increases, the goodwill does not seem to decrease in value. However, the purchased goodwill is then deemed to have been replaced by internally generated goodwill. As DAS 210 does not permit capitalisation of internally generated goodwill, goodwill arising from an acquisition is consistently amortised over its estimated economic life.

Amortisation period
The amortisation period must be based on the period in which future economic benefits flow to the acquirer. A rebuttable assumption is applied that the economic life does not exceed twenty years from the time of acquisition (DAS 216.221). In exceptional cases where the economic life cannot be reliably estimated, goodwill is amortised over a maximum period of ten years (Article 2:386(3) NCC).

Amortisation method
The amortisation method applied must reflect the pattern in which the future economic benefits are expected to flow to the acquirer. If the pattern cannot be reliably determined, the straight-line method must be used. The amortisation method is applied consistently, unless the pattern in which the economic benefits flow to the party has changed (DAS 216.222).

Presentation
Amortisation must be charged to the profit and loss account in the item " amortisation / depreciation of intangible and tangible fixed assets" (DAS 216.223).

Determination of economic life
The Dutch Accounting Standards Board considers the economic life of goodwill to be finite. Uncertainty justifies a conservative estimate of the economic life, but not if it results in an unrealistically short life (DAS 216.226).

Factors for determining economic life
Many factors need to be considered in determining the economic life of goodwill. Importantly, goodwill is derived from the price paid for the acquiree's earnings potential, which means that its life depends on such factors as (DAS 216.225):

- the nature and foreseeable life of the activities acquired;
- the stability and foreseeable life of the industry;
- public information on characteristics and life cycles of similar activities;
- the impact of product obsolescence, changes in market demand and other economic factors related to the activities acquired;
- the expected length of service of key personnel or groups of employees and the dependence of the activities acquired on the existing management team;
- the level of investment and financing needed to realise the expected economic benefits of the acquiree and the acquirer's ability and intention to maintain this required level;
- the behaviour expected of competitors or potential competitors; and
- the period for which economic power of disposal over the activities acquired has been obtained and provisions in law, articles of association or contracts affecting the economic life.

Life of goodwill exceeding twenty years
In exceptional cases, there may be compelling evidence that the economic life of goodwill is longer than twenty years. Goodwill may be clearly associated with an identifiable asset or a group of identifiable assets. In that case, future economic benefits can reasonably be expected to accrue to the acquirer during the life of the identifiable asset or group of identifiable assets. The assumption that the economic life does not exceed twenty years can then be rebutted and the entity will (DAS 216.225a):

- amortise the goodwill over the best estimate of its economic life;
- review at least annually whether the goodwill must be impaired; and
- explain the reason for rebutting the assumption, as well as the factors that played a significant role in determining the economic life of the goodwill.

Impairments
In some cases, the activities for which goodwill was paid may produce no or fewer future economic benefits, e.g. if the expected future economic benefits ensuing from the identifiable assets acquired have clearly diminished since the date the acquisition cost was fixed. In this case, the acquirer tests whether the goodwill is impaired in accordance with DAS 121 (see Chapter 10).

Review of amortisation period and method
The amortisation period and method must be reviewed at least at the end of each financial year. Reviewing the estimation period and method involves changes in accounting estimates (see also Chapter 3). If the expected economic life of the goodwill differs significantly from previous estimates, the amortisation period must be adjusted accordingly. If there is a significant change in the expected pattern in which the economic benefits of the goodwill flow to the acquirer, the amortisation method must be adjusted accordingly (DAS 216.228).

6.2.3 Allocation of goodwill and impairment test

In an acquisition, the goodwill must be allocated to all cash-generating units or all groups of cash-generating units that, after the acquisition, are expected to benefit from the synergies created with the acquisition. Goodwill must also be allocated when part of a cash-generating unit is sold and when cash-generating units are changed due to restructurings. These provisions are discussed in more detail in paragraphs 10.4.3 and 10.4.4. Reference is again made to DAS 121 for the further determination of whether goodwill is impaired (see Chapter 10).

In addition to what is regulated in DAS 121, for goodwill whose estimated economic life is longer than twenty years from the time of recognition, an estimate of its recoverable amount must be made at least at the end of each financial year, even if there is no indication of impairment (DAS 216.230).

The annual test also applies where an economic life of less than twenty years was initially expected, but the total life is estimated at more than twenty years in a subsequent review of the amortisation period. If it is established at the time of acquisition that the expected economic life is longer than twenty years, but at a later date it is established that the total life is shorter than twenty years, the annual test lapses (DAS 216.231).

6.2.4 Presentation and disclosure

The following must be disclosed in the financial statements when it comes to goodwill (DAS 216.403):

- the amortisation period used;
- if goodwill is amortised over a period not exceeding ten years because the useful life of goodwill cannot be reliably estimated, the reasons for the amortisation period chosen. When giving these reasons, the acquirer must describe the factors that played a significant role in determining the life of the goodwill while considering the list of factors set out in paragraph 6.2.2;
- if goodwill is amortised over a period of more than twenty years, the reason for rebutting the assumption that the economic life of goodwill does not exceed twenty years (see paragraph 6.2.2). Here, too, the acquirer considers the list of factors set out in paragraph 6.2.2;
- if goodwill is not amortised using the straight-line method, the amortisation method applied and the reason why this method is more appropriate; and
- the item in the profit and loss account in which the amortisation is recognised.

A movement schedule of the carrying amount of the goodwill must be recognised for the reporting period, which reflects (DAS 216.403):

- the gross value and accumulated amortisation (aggregated with impairment losses) at the beginning of the period;
- additionally recognised goodwill;
- adjustments made to the goodwill in response to subsequently identified assets and liabilities and changes in their value;
- goodwill written off during the period in response to the disposal of some or all of the activities to which the goodwill relates;
- amortisation;
- impairment losses. The acquirer provides the information on impaired goodwill in accordance with DAS 121 (see Chapter 10);
- other changes in the carrying amount; and
- the gross value and accumulated amortisation (aggregated with impairment losses) at the end of the period.

The Dutch Accounting Standards Board recommends including comparative figures from the previous financial year in the movement schedule if that is important to gain an understanding of the item in question (DAS 110.127). Disclosing the tax effect of the goodwill amortisation in the notes is recommended (DAS 216.403).

6.3 Negative goodwill in an acquisition

6.3.1 Recognition

Definition
The excess of the interest in the fair values of the identifiable assets and liabilities on the acquisition date over the consideration paid must be recognised as negative goodwill (DAS 216.233).

Recognition method
Once negative goodwill arises, it must be determined whether all of the acquiree's identifiable assets and liabilities are included in the determination of the negative goodwill, also considering possible restructuring provisions to be formed (based on DAS 216.212). It must then be determined whether the assets and liabilities identified have been measured at the correct fair values.

To the extent that negative goodwill relates to expected future losses and expenses that have been taken into account in the acquisition plan and that can be reliably measured but do not yet constitute an identifiable liability on the acquisition date, this portion of negative goodwill must be credited to the profit and loss account as those losses and expenses arise (DAS 216.235). If these expected losses and expenses are not recognised in the period in which they were expected, the negative goodwill must be treated in accordance with the provision below for negative goodwill resulting from a "lucky buy".

Negative goodwill resulting from a lucky buy is the part of negative goodwill that does not relate to expected future losses and expenses (the "remainder").

This negative goodwill resulting from a lucky buy is credited to the profit and loss account as follows (DAS 216.235):

- the portion of negative goodwill that does not exceed the fair value of identifiable non-monetary assets acquired is consistently credited to the profit and loss account on a systematic basis in proportion to its realisation as a result of the amortisation or depreciation or sale of the acquired non-monetary assets. The period in which the realisation due to amortisation or depreciations occurs can usually be approximated by determining the weighted average remaining useful life of the amortisable and depreciable assets acquired; and
- the portion of negative goodwill that exceeds the fair value of identified non-monetary assets is immediately credited to the profit and loss account.

Negative goodwill is recognised as a separate accrued liability (DAS 216.235).

Example: Negative goodwill

Company A buys company B for 0.01 because B is in financial trouble. There is no expected underperformance. Company A recognises and amortises positive goodwill. A identifies the following assets and liabilities at fair value:

	Fair value	Remaining life (in years)
Intangible fixed assets*	0	
Tangible fixed assets: machinery	50	5
Tangible fixed assets: buildings	150	9
Inventory	15	
Receivables	25	
Cash	15	
Debt	(30)	
	225	
Acquisition cost (= 0.01)	0	
Negative goodwill	225	

Negative goodwill can be specified as follows:

Negative goodwill equal to the fair value of the identifiable non-monetary assets	215
Negative goodwill higher than the fair value of the identifiable non-monetary assets	10
Total	225

The amount of 215 is recognised as a separate liability and credited to the profit and loss account in proportion to its realisation as a result of the amortisation or depreciation or sale of the related non-monetary assets. Assume that inventories are realised by sale and tangible fixed assets by depreciation. An amount of 15 of the negative goodwill is released in the period in which the inventories are sold. An amount of 200 is realised in proportion to the weighted average remaining life of the amortisable assets acquired. The weighted average life is eight years (= ((50 x 5) (150 x 9)) / 200). This means that 200 will be credited to the profit and loss account in eight years. The remainder of the negative goodwill in the amount of 10 is credited to the profit and loss account as a lump sum.

* When the fair value of an intangible fixed asset cannot be determined by reference to an active market, the amount to be capitalised must be limited to an amount that does not create or increase negative goodwill (DAS 216.215).

6.3.2 Disclosure

The following information is required to be included in the notes relating to negative goodwill (DAS 216.406):

- the period in which the negative goodwill is credited to the profit and loss account;
- the item of the profit and loss account in which the gain related to the negative goodwill is recognised; and
- if negative goodwill relates to expected future losses, a description of these losses, their amount, and the period in which they will occur.

A movement schedule of the carrying amount of the negative goodwill is also recognised for the reporting period, which reflects (DAS 216.406):

- the gross value and accumulated negative goodwill already credited to the profit and loss account at the beginning of the period;
- additionally recognised negative goodwill;
- adjustments made to the negative goodwill in response to subsequently identified assets and liabilities and changes in their value;
- negative goodwill written down during the period in response to the disposal of some or all of the activities to which the goodwill relates;
- negative goodwill credited to the profit and loss account showing separately the portion of the negative goodwill credited to the profit and loss account as it does not relate to expected future losses and expenses;
- other changes in the carrying amount; and
- the gross value and accumulated negative goodwill already credited to the profit and loss account at the end of the period.

The information described in this paragraph must be included for mergers and acquisitions realised after the reporting date. If it is not practically possible to provide this information, this must be disclosed as such (DAS 216.410).

6.4 Changes in the value of the goodwill (positive and negative)

The value of goodwill may change due to adjustments to the net asset value or adjustments to the acquisition cost. Adjustments to the net asset value may result from the recognition of subsequently identified assets and liabilities or from subsequent changes in the value of assets and liabilities already identified. The acquisition cost may be adjusted later depending on future events. See paragraph 31.3.7 for an explanation of the prescribed recognition of such adjustments.

6.5 Goodwill on the (partial) sale of a participating interest

On the sale of a participating interest, the carrying amount of the recognised goodwill (or of the negative goodwill shown as debt) relating to that participating interest must be charged (or credited) to the profit and loss account as part of the gain or loss on that disposal. In the event of a partial sale, this applies to the proportionate share of the goodwill (DAS 214.341a).

6.6 Exemptions for medium-sized and small entities

Medium-sized entities are exempt from the disclosure requirements relating to mergers and acquisitions realised after the reporting date. They may limit themselves to disclosing subsequent events with significant financial consequences for the entity, stating the extent of these consequences (DAS 216.410).

Small entities need only include the information required by law in the notes and may consider disclosing additional information ("over and above the legal minimum") in the notes.

6.7 Significant differences from IFRS

Amortisation of goodwill
IFRS 3 "Business Combinations" requires goodwill to be measured at cost less accumulated impairment losses. IFRS does not permit systematic amortisation of goodwill based on economic life. DAS 216 'Business Combinations' provides that capitalised goodwill is systematically amortised based on its economic life (referred to by the legislator as its "expected useful life"). There is a rebuttable assumption that the economic life of goodwill will not exceed twenty years. Article 2:386(3) NCC provides that if the expected useful life cannot be reliably estimated, goodwill is amortised over a maximum period of ten years.

Recognition of negative goodwill
IFRS 3 provides that if the balance of the fair values of the identified assets and liabilities (including contingent liabilities) exceeds the cost of acquisition (negative goodwill), the difference must be credited directly to the profit and loss account. However, it must first be established once again that the identifiable assets and liabilities acquired (including contingent liabilities) were recognised and measured in accordance with IFRS. Dutch law contains no provisions on the recognition of negative goodwill. DAS 216 distinguishes between negative goodwill relating to expected future losses and expenses and other negative goodwill. For both categories, realisation through the profit and loss account is subject to conditions, as described in paragraph 6.3.1.

Translation of goodwill paid for a foreign operation
IAS 21 'The Effects of Changes in Foreign Exchange Rates' requires goodwill paid on the acquisition of a foreign operation to be treated as an asset of the foreign operation (therefore part of the translation of the foreign operation at the exchange rate on the reporting date). DAS 122 'Measurement bases for foreign currency' *also* allows goodwill paid on the acquisition of a foreign operation to be expressed in the functional currency of the acquiring entity, or to be classified as a non-monetary foreign currency item and recognised at the exchange rate on the acquisition date. Therefore, if this DAS option is used, the goodwill of a foreign operation that was paid is no longer subject to exchange rate risk because one-off translation (into the functional currency of the acquiring entity) takes place on the acquisition date. See also paragraph 4.9.

7 Tangible fixed assets

7.1 Introduction

Tangible fixed assets refer to tangible assets that are intended to support the entity's operations on a continuing basis (DAS 212.0). 'Supporting operations' means that an asset is intended for use in the production or supply of goods or services, for lease to others or for administrative purposes. 'On a continuing basis' means that the asset is expected to be of support for more than one reporting period (DAS 212.0). Whether the assets belong to tangible fixed assets or inventory depends on the function of the assets. Goods intended to be sold or consumed (immediately) in the production of goods or provision of services are included in inventory. They are not used nor do they support the activity of the entity on a continuing basis.

This chapter does not deal with tangible fixed assets held as investment property. For the recognition of investment properties, see Chapter 8.

7.2 Recognition on the balance sheet

7.2.1 Recognition in general

General
A tangible fixed asset must be recognised as an asset in the balance sheet if:

a. it is probable that future economic benefits relating to the asset will flow to the entity; and
b. the cost of the asset (purchase or construction cost) can be reliably determined (DAS 212.201).

The fact that a tangible fixed asset is in use by the entity normally implies that future economic benefits flow to the entity.

Paragraph 7.3.1 discusses the measurement of the tangible fixed asset in the balance sheet on initial recognition.

Subsequent expenditures
Expenditures incurred after initial recognition must be recognised as part of the cost of the tangible fixed asset if they meet the recognition criteria.

Subsequent expenditures that may lead to future economic benefits related to the asset include capacity expansions and qualitative improvements (saving energy consumption, improving production process, etc.). These expenditures are also referred to as expansion investments.

Subsequent expenditures relating to the replacement of significant components of an asset are also recognised in the carrying amount of the asset (see also paragraph 7.4.2). This recognition occurs even if the expenditures were not initially identified as a significant component (when the asset was initially recognised), for example because the entity estimated that the useful life of the components would equal that of the total asset. These expenditures are also referred to as replacement investments (DAS 212.206).

Renewal, safety and environment expenditures
Tangible fixed assets can also be acquired for safety or environmental reasons. Although acquisition of such tangible fixed assets does not directly increase future benefits, acquisition may be necessary to obtain future economic benefits from other assets. Such tangible fixed assets qualify for recognition as tangible fixed assets as more future benefits are obtained with the combined assets (DAS 212.205).

If the capitalisation criteria are not met, the costs should be charged directly to the profit and loss account.

Example: Capitalising expenditures to comply with environmental standards (extracted from DAS 212.205)

A chemical product manufacturer implements a new treatment process to meet environmental standards for production and storage. The costs of related plant improvements are capitalised. After all, without the improvements, the manufacturer does not meet environmental standards and therefore cannot produce or sell chemicals. The carrying amount of this asset and the carrying amounts of related assets are reviewed for impairment, if applicable (see Chapter 10).

Beneficial ownership versus legal title
In determining whether capitalisation should take place, it is not legal title but beneficial ownership that is decisive (DAS 212.207). Finance leases relating to tangible fixed assets thus lead to capitalisation of the lease object and recognition of the lease liability. See Chapter 22 on this subject. If the entity has beneficial ownership but not legal title, this must be disclosed in the notes to the balance sheet (Article 2:366(2) NCC). If an entity incurs costs to rebuild an asset that is only beneficially owned (e.g. a lessee constructing buildings on leasehold or long-term leasehold land), the expenditures should be capitalised as tangible fixed assets if it is probable that the future economic benefits will flow to the entity (DAS 212.207).

Spare parts and spare equipment
Spare parts and spare equipment are classified as tangible fixed assets if the assets are expected to be used for more than one period. Spare parts and spare equipment that can only be used as part of a tangible fixed asset are also recognised as tangible fixed assets. In exceptional cases, classification as inventory is also possible, for example if spare parts are held both for own tangible fixed assets and for inventory that has been sold and is being sold (DAS 212.202).

Tangible fixed assets on order
Tangible fixed assets on order should not be recognised on the balance sheet (DAS 212.604). Investment commitments entered into do not meet the definition of an asset or a financial liability, but can be classified as executory contracts. These are contracts under which both parties have performed their obligations after the reporting date, or both parties have partially performed their obligations to an equal extent by the reporting date (DAS 940 '*niet afgewikkelde overeenkomst*').

Such executory contracts are disclosed under contingent liabilities. Any payments for these assets are capitalised under the item 'tangible fixed assets under construction and prepayments on tangible fixed assets' (Article 2:366(1)(d) NCC).

Rights of ground lease
If ground leases meet the definition of lease contracts, DAS 292 'Leasing' applies (see Chapter 22). This means that if the ground lease qualifies as a finance lease, the lease object is recognised as a tangible fixed asset on the lessee's balance sheet with the related finance lease liability against it. The usual provisions for depreciation of the lease object, impairments and accounting for borrowing cost also apply (see Chapter 22).

7.2.2 Recognition of costs of major maintenance

The Dutch Accounting Standards Board distinguishes between (1) significant components of a tangible fixed asset and (2) major maintenance. This distinction is important because replacement investments (i.e. replacement of significant components) are capitalised and depreciated, while major maintenance may also be recognised through a provision for major maintenance. The terms 'significant components' and 'major maintenance' are defined as follows (DAS 212.0):

- a 'significant component' is defined as part of a tangible fixed asset whose cost is significant in relation to the total tangible fixed asset;
- 'costs of major maintenance' are defined as costs arising from (periodic) work after an extended period of use to maintain the current condition of an asset, which cannot be distinguished as replacements of significant components of the tangible fixed asset and which do not qualify as frequent maintenance costs.

If significant components of a tangible fixed asset are replaced, they should be recognised in the carrying amount of the asset (DAS 212.206 and 418). Frequent maintenance costs are recognised in the profit and loss account when they are incurred (DAS 212.447).

Examples of major maintenance may include overhaul, refurbishment and periodic inspection of an asset. Overhaul, refurbishment and periodic inspection can mostly be classified by their nature as major maintenance and not as significant components of an asset. The costs of major maintenance may be significant in relation to the total cost of the tangible fixed asset. An example of major maintenance is the periodic inspection of a production facility that involves inspection of components such as the furnaces and roof, where minor replacements may be made if necessary (DAS 212.445).

It is not major maintenance if a significant component of the asset is replaced. Thus, for significant components that will be replaced after a certain period, a provision for major maintenance cannot be formed, instead the component approach must be applied (see paragraph 7.4.2).

It may be major maintenance when many smaller components are replaced at the same time. If an inspection, overhaul or refurbishment involves larger replacements, these may be replacement investments that need capitalising as part of the asset. In practice, a variety of intermediate forms occur and it must be assessed whether these are classified as major maintenance or replacement. These intermediate forms require a higher degree of judgement by the company's management and may qualify as replacement investment or major maintenance depending on their nature and specific facts and circumstances. Judgements are made based on the nature and specific facts and circumstances. For these intermediate forms, it is important that a classification, once chosen, is applied consistently (DAS 212.445).

Major maintenance is distinguished from frequent maintenance by, among other things, the nature, scope and (in)frequency of the maintenance (DAS 212.445). Major maintenance takes place each time after a longer period of use.

Costs of major maintenance of tangible fixed assets that occur each time after an extended period of use are recognised in one of two ways (DAS 212.445):

a. in the carrying amount of the asset (also known as the 'component approach'); or
b. through a provision for major maintenance.

The recognition of costs of major maintenance should be the same for all similar tangible fixed assets (DAS 212.446). The notes should disclose how major maintenance is recognised (DAS 212.701(b)). The option to recognise costs of major maintenance in the profit and loss account as a lump sum has expired with effect from reporting periods commencing on or after 1 January 2019.

Re a. Costs of major maintenance in the carrying amount of the asset
If the costs of major maintenance are recognised in the carrying amount of the asset, the distinction between replacement of significant components and major maintenance is less relevant. Under this recognition method, the costs of major maintenance are recognised in the same way as a significant component of a tangible fixed asset and depreciated separately over its useful life (see also paragraph 7.4.2). This recognition method should be applied from the initial recognition (i.e. from acquisition) of the asset (DAS 212.448).

If, as a result of performing major maintenance, the costs are recognised in the carrying amount of the tangible fixed asset, the remaining carrying amount (if any) of the previous major maintenance is derecognised and regarded as a disposal. Any remaining carrying amount of previous major maintenance should be charged to the profit and loss account in a lump sum (DAS 212.449).

Example: Costs of major maintenance as part of the carrying amount

Company A carries out thorough periodic inspections of a ship every five years to detect defects. A classifies the costs of these inspections as major maintenance. A recognises these costs in the carrying amount of the ship. On inspection any remaining carrying amount of the costs of the previous inspection is derecognised. This takes place regardless of whether the costs of the previous inspection were separately identified when that previous inspection was carried out or when the ship was purchased.

If necessary, the cost of the current inspection may be used as an indication for determining the component in the cost of inspection at the time the asset was acquired or constructed (DAS 212.450). This can only be the case if the costs of the previous inspection had not been separately identified.

Re b. Costs of major maintenance through provision for major maintenance
As a second recognition method, it is permissible to create a provision for major maintenance during the use of the asset until the time that major maintenance takes place. The creation of a provision for major maintenance to be carried out is based on Article 2:374(1) NCC.

If an entity recognises costs of major maintenance through a provision for major maintenance, significant components must be distinguished (to the extent relevant) at the time of acquisition of the asset and depreciated over their own useful lives ('component approach'). If a significant component is replaced then this is a replacement investment which is capitalised again as a component and depreciated over its useful life. Such replacement investments are therefore not costs of major maintenance and therefore cannot be recognised through a provision for major maintenance. Thus, if the costs of major maintenance are recognised through a provision for major maintenance, the distinction between replacement of significant components on the one hand and major maintenance on the other is relevant. That distinction requires a higher degree of judgement.

Additions to the provision should be determined on the basis of the estimated amount per maintenance component and the period in each case between major maintenance activities. This amount per maintenance component should be added to the provision on a systematic basis as a charge to the profit and loss account. If price movements warrants it, additions are indexed or additional amounts are added to the provision (DAS 212.451). This then concerns a change in accounting estimates (see paragraph 3.2).

The provision for major maintenance, given its nature (for equalisation of costs of major maintenance) is usually valued at face value (DAS 212.451). On measurement of the provision at face value, we believe that it should be based on the amount of major maintenance that the entity would have to pay now if the asset component were already the expected age at which major maintenance is due. Thus, no account is taken of the expected price level at the time the major maintenance will take place. On each reporting date, the provision is determined based on the then prevailing price level (best estimate). When the provision is measured at present value, estimates of future cash flows and the discount rate should consistently reflect assumptions about price increases due to inflation. Accounting estimates of future cash flows and the discount rate are then both expressed in nominal terms or both in real terms (see paragraph 16.4).

Example: Component approach and provision for major maintenance

A tangible fixed asset acquired and put into use at the beginning of year 1 has a purchase cost of 140,000 and a useful life of 12 years. Major maintenance is needed every four years at an estimated cost of 20,000.

Costs of major maintenance under the component approach in the asset's carrying amount
On acquisition, the asset is divided into two components: a main component of 120,000 depreciated over 12 years and a maintenance component of 20,000 depreciated over four years. The straight-line depreciation per year (assume residual value is zero) is then 15,000 (= 1/12 of 120,000 plus 1/4 of 20,000). After four years, the carrying amount is 80,000 and the expenditure on major maintenance of 20,000 is capitalised again so that the carrying amount after the performance of major maintenance is 100,000. After eight years, the carrying amount before major maintenance is 40,000 and after major maintenance is 60,000. After 12 years, the carrying amount is zero.

Costs of major maintenance through provision for major maintenance
If the costs of major maintenance are included in a provision for major maintenance, the annual depreciation is 11,667 (= 1/12 of 140,000). After 12 years, the carrying amount of the asset is zero. In addition, an amount of 5,000 (= 20,000/4) is added to the provision for major maintenance every year in year 1 to year 4. At the end of the fourth year, major maintenance will be performed and its cost of 20,000 will be charged to the provision. At the end of the fourth year, the

carrying amount of the provision is zero. This is repeated in years 5 to 8. In years 9 to 12, there is no addition to the provision for major maintenance. After all, no more major maintenance will be performed.

Comparison of component approach and provision for major maintenance
The table below illustrates what the annual recognised depreciation charges and maintenance costs are when applying the two permitted methods of recognition for major maintenance.

	Depreciation costs and costs of major maintenance	
	In the asset's carrying amount (component approach)	**Provision for major maintenance**
year 1	15,000	16,667
year 2	15,000	16,667
year 3	15,000	16,667
year 4	15,000	16,667
year 5	15,000	16,667
year 6	15,000	16,667
year 7	15,000	16,667
year 8	15,000	16,667
year 9	15,000	11,667
year 10	15,000	11,667
year 11	15,000	11,667
year 12	15,000	11,667
Total	180,000	180,000

This example shows that, when applying the component approach, the annual charge (depreciation charges including maintenance costs) remains the same throughout the useful life. Applying the component approach, the costs of major maintenance are allocated to the period of use of the maintenance in question. When recognising the costs of major maintenance through a provision for major maintenance, the annual charges are higher during the first years of the asset's useful life, and lower during the final years. This is because in the last period no more additions are made to the provision, as no more major maintenance needs to take place.

Example: Addition to provision for major maintenance

An entity recognises the costs of major maintenance in a provision for major maintenance. The entity has moved into new premises. The acquisition value of the property is 16 million. The useful life is estimated at 30 years and the residual value at 1 million. The annual depreciation of the property is 500,000.

The entity recognises two components of major maintenance, each of which is included in the provision for major maintenance for one cycle:

- The entity estimates that major maintenance of the roof will be required in 20 years. The expected cost is 2 million. The annual addition to the provision for major maintenance is 100,000.

- In addition, the entity estimates that major plant maintenance will be required in eight years. The estimated cost is 1 million. The annual addition to the provision for major maintenance is 125,000.

The addition to the provision for major maintenance in year 1 is 225,000 (= 100,000 + 125,000).

The actual costs of major maintenance performed should be charged to a provision for major maintenance to the extent that this provision has been recognised for the intended costs. If the actual costs of major maintenance performed differ from the carrying amount of the provision held for the maintenance component concerned, the difference is recognised in profit or loss (DAS 212.452).

Example: Withdrawal from provision for major maintenance

The entity from the previous example carries out major plant maintenance in year 8. The provision for the relevant component is 1 million. The costs for the relevant maintenance are 0.9 million. As the provision formed for the major maintenance exceeds the costs incurred in year 8, the difference (0.1 million) is released to profit or loss.

If the costs of major maintenance in year 8 had been higher than the provision formed for the relevant component, for example 1.2 million, the difference (0.2 million) would have been charged to profit or loss.

If costs of major maintenance are recognised through a provision for major maintenance, the provision for major maintenance is recognised on the balance sheet as part of the other provisions (DAS 212.605).

Change in accounting policy from costs of major maintenance to component approach
The Dutch Accounting Standards Board have included a transitional provision for a change in accounting policy whereby costs of major maintenance are no longer recognised through a provision for major maintenance, but are recognised in the asset's carrying amount (component approach). The application of a transitional provision should be disclosed in the financial year in which the transition is recognised.

A change in accounting policy from 'provision for major maintenance' to 'component approach' can be recognised as follows (DAS 212.807):

1. retrospectively in accordance with DAS 140 'Changes in accounting policies';
2. retrospectively from the previous financial year; or
3. retrospectively from the current financial year.

7.3 Measurement

7.3.1 Measurement at initial recognition

Tangible fixed assets should be measured at cost at initial recognition (DAS 212.301). The cost of a tangible fixed asset consists of its purchase or construction cost and other costs incurred to bring it to the location and condition necessary for its intended use (DAS 212.302).

The construction cost
The construction cost includes the acquisition cost of raw materials and consumables used and other costs directly attributable to construction. It may also include a reasonable proportion of indirect costs and borrowing costs for the period attributable to the construction of the asset (Article 2:388(2) NCC).

The indirect cost capitalisable in the construction cost may be indirect manufacturing costs. It should be disclosed which categories of indirect costs are included in the construction cost.

Trade and other discounts are deducted from the cost of a tangible fixed asset. Import duties and non-refundable taxes (e.g. transfer tax) are part of the cost.

If land is purchased with buildings, with the intention of demolishing the buildings prior to completion of a new build, the carrying amount, if any, of the buildings and the demolition costs incurred become part of the purchase cost of the land (DAS 212.302).

In our view, this also applies to the carrying amount and demolition costs of existing buildings at the end of their useful lives if a new build is being developed on the same land in their place. However, the condition is that the buildings are then depreciated to their residual value at the end of their useful lives.

Example: Demolition costs of existing buildings for a new build

Company A demolishes existing buildings at the end of their useful life and builds new buildings on the same land. The buildings have been depreciated to their residual value at the time of demolition. The carrying amount and demolition costs of the buildings are considered part of the cost of the land. After all, if the land with the buildings for demolition had been acquired from a third party, the residual value (e.g. the foundations) of the existing buildings and the demolition costs would have been factored into the purchase price of the land. That carrying amount and those demolition costs are considered as costs needed to make the land suitable for a new building ('site preparation' of the land). The entity assesses whether the capitalisation of demolition costs will result in an indication of land impairment.

Examples of construction and other directly attributable costs may include (DAS 212.303):

- staff costs directly attributable to the purchase or construction of a tangible fixed asset;
- costs for making the site suitable;
- delivery and handling costs;
- installation and assembly costs;
- costs of investigating whether the asset is functioning properly; and
- advisers' fees.

Until an asset is in the location and condition necessary for its intended use, the revenues from the sale and related costs of material produced with the asset are (DAS 212.303):

- deducted from the cost of the asset (tangible fixed asset); or
- alternatively, recognised in the profit and loss account.

An example concerns the revenues from the sale of manufactured samples when the asset is tested.

The alternative of recognising these revenues and related expenses in the profit and loss account is allowed for financial years beginning on or after 1 January 2022. If the alternative recognition method is applied, this entails a change in accounting policy. A transitional provision stipulates that the adjustment should be recognised retrospectively from the previous financial year, for only those assets that are in the location and condition necessary for their intended use at or after the beginning of the previous financial year (DAS 212.808).

Example: Application of transitional provision for alternative revenue recognition method

A manufacturer of chemical products (A BV) has had a number of production facilities developed. Facility X was commissioned in year 1 and Facility Y was commissioned in year 2. Part of the facilities' installation process involves producing samples. These samples were sold to a third party during the installation process for an amount of 100 (Facility X, year 1) and an amount of 200 (Facility Y, year 2), respectively.

In the financial statements up to year 2, A BV deducted these revenues from the cost of the production facilities (tangible fixed asset). In year 3, based on the amended standards, A BV decides to make a change in accounting policy in the financial statements for year 3 and recognise such revenues directly in the profit and loss account.

The impact of the change in accounting policy on the financial statements for year 3 is as follows:

- A should apply the transitional provision, which only requires adjusting the revenue recognition of Facility Y of 200. This is because this asset was in the location and condition necessary for its intended use on or after the beginning of the previous financial year (year 2). The capitalised revenue of 100 in year 1 on Facility X is not included in this change in accounting policy;
- equity at the beginning of the previous financial year is recalculated;
- the revenues of Facility Y in year 2 of 200 are recognised in the comparative figures of the profit and loss account for year 2 in the financial statements for year 3, and the cost of this production facility (tangible fixed assets) is increased by 200 in year 2. This also leads to higher depreciation costs from year 2.

Costs not recognised in the cost of a tangible fixed asset are (DAS 212.304):

- costs of opening a location;
- costs of launching a new product or service (including advertising and promotion costs);
- operating costs at a new location or for a new market (including staff training costs); and
- administration costs and other general overheads.

Recognition of costs in the carrying amount of a tangible fixed asset must cease when the item is in the location and condition necessary for its intended use. Costs associated with the use of the asset or costs incurred for an alternative use of a tangible fixed asset should not be included in the carrying amount of that asset (DAS 212.305).

For example, the following costs are not included in the carrying amount of a tangible fixed asset (DAS 212.305):

- costs incurred for a tangible fixed asset that is already capable of operating as intended but has not yet been put into service or is operating below its optimum production capacity;
- operating losses, including start-up losses on sales of new products produced with the asset; and
- costs of relocating or restructuring all or part of the entity's operations.

The construction or development of a tangible fixed asset may give rise to operations that are not necessary to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended. These incidental operations may occur before or during construction or development activities. For example, a building site can generate revenue by using it as a car park until construction starts. Revenues and related expenses are recognised in the profit and loss account because such incidental operations are not necessary to bring the asset to the location and condition necessary for it to be capable of operating in the manner intended (DAS 212.306).

The cost of a self-constructed tangible fixed asset is determined using the same accounting principles as for an acquired asset. If similar assets are constructed for sale as part of ordinary operations, the cost according to this chapter is usually equal to the cost according to the accounting principles for inventory (see Chapter 11). Any internal profits are eliminated in determining cost. Abnormal costs related to wasted materials, labour and other resources used in the construction of an asset are not part of the cost of the asset (DAS 212.307).

If payment of the cost of a tangible fixed asset is based on a longer than normal payment period, the cost of the asset should be based on the present value of the liability (DAS 212.308).

Capitalisation of borrowing costs
Only interest payable on debt for the period attributable to the construction of the asset may be capitalised (Article 2:388(2) NCC). The inclusion of borrowing costs in the construction cost is only acceptable for qualifying assets. These are assets that necessarily require a significant amount of time to make them ready for use (DAS 273.0). Furthermore, capitalisation of borrowing costs is only acceptable if the future benefits associated with the asset are sufficient to cover the carrying amount including allocated interest and these benefits can also be determined with sufficient reliability (DAS 273.204).

The borrowing costs to be capitalised is calculated based on the interest payable on the loans specifically borrowed for the construction less any investment revenues obtained from temporary investments of these loans. If no specific financing has been raised, the borrowing costs to be capitalised is calculated based on a weighted average interest rate of the financing available at that time (DAS 273.207). Capitalisation of borrowing costs commences when on balance (after deducting advance payments to the client and any government grants) expenditure is first incurred and ends when the asset is substantially completed. The amount of borrowing costs capitalised may not exceed the actual interest payable over a period. If no manufacturing activities take place for an extended period of time, capitalisation of borrowing costs is temporarily interrupted unless the interruption of manufacturing is necessary to make the asset ready for use or if significant technical and organisational work is performed during the period of interruption (DAS 273.208-210). See also Chapter 27.

The recoverable amount of the asset must exceed its carrying amount including capitalised indirect costs and capitalised borrowing costs (DAS 273.212). On this subject, see also Chapter 10.

7.3.2 Restoration cost at initial recognition

Obligations for the costs of restoration (such as dismantling costs or costs for restoring a site to its original condition) can be incurred either:

- when the asset is acquired; or
- as a consequence of using an asset.

An example of an obligation that arises when an asset is acquired is a restoration obligation for retirement of a nuclear power plant. An example where a restoration obligation arises as a consequence of using an asset is sand mining, where the site in question must be restored in accordance with agreements.

Restoration cost as a result of acquiring an asset
If the obligation to restore arises from the acquisition of an asset, a provision for restoration costs should be made to settle this obligation to restore. This can be done in two ways (DAS 212.435):

a. as part of the asset's carrying amount; or
b. through the build-up of a provision for restoration costs over the asset's useful life.

Re a. Restoration cost (as a result of the acquisition of an asset) as part of the asset's carrying amount
When the obligation to restore is recognised as part of the asset's carrying amount, a provision is made for the present value of the entire expected amount of the restoration costs when the asset is constructed (DAS 212.437). The amount for which this provision is recognised when the asset is acquired, is capitalised as part of the cost of the asset. Under this method of recognition, in addition to depreciation costs, the annual interest accrual of the provision is charged to profit or loss.

Example: Recognising restoration costs as part of the asset's carrying amount

A Company has acquired and commissioned a drilling platform that is due to be demolished at the end of its 40-year useful life. The acquisition value of the platform is 110.000. The estimated end-of-life cost of restoration (demolition) as a result of constructing the asset is 217.200. The present value of this amount (calculated at a discount rate of 8% over a 40-year period) is 10.000.

Journal entry on capitalisation of restoration costs:

Drilling platform	120.000	
Provision for restoration costs		10.000
Accounts payable		110.000

Journal entry depreciation in year 1:

Depreciation costs	3.000	
Drilling platform		3.000

Journal entry of interest accrual of the provision in year 1:

Interest expense	800	
Provision for restoration costs		800

The total cost in year 1 is 3.800. Because of the progressive nature of the interest expense, the annual cost will keep increasing.

If the cost of restoration is included in the cost of land, the depreciation period of the capitalised cost of restoration is equal to the period in which the benefits are obtained from incurring these costs. In some cases, the land itself may have a limited useful life and will be depreciated according to the benefits derived from it (DAS 212.442).

Re b. Build-up of a provision for restoration costs (as a result of the acquisition of an asset) over the asset's useful life
When recognising the obligation to restore through the build-up of a provision, an annual addition is made to the provision for restoration costs. This addition is charged to the profit and loss account along with the annual

depreciation costs relating to the asset. The provision can be measured at present value or face value. As there is a gradual build-up of a provision (giving the provision the character of an equalisation provision), it is usually measured at face value (DAS 212.443). In the latter variant, the total restoration obligation should be disclosed as a contingent liability (DAS 212.703(f)).

Example: Recognition of restoration costs via the build-up of a provision for restoration costs over the asset's useful life

See data from previous example. If the company were to recognise the restoration costs through the build-up of a provision and value this provision at face value, the annual addition to the provision would be 5,430 (217,200/40). The depreciation costs for the rig are 2,750 (110,000/40) so the total annual cost is 8,180.

Restoration cost as a result of the use of an asset
If a tangible fixed asset incurs restoration costs as a result of the use of an asset, a provision should be made as and when the activities take place (DAS 212.436). In this situation, it cannot be said that the restoration costs already form part of the cost at the time of acquisition of the asset. An example is soil contamination that arises as a result of using the asset during its useful life when the entity has a duty to clean up the contamination created at the end of the assets useful life. Accordingly, it is clear that at the time the asset is recognised that there is no liability yet. This liability only arises during the use of the asset. Restoration costs arising from the use of an asset to produce inventory are recognised as part of the manufacturing cost of that inventory. Also in this situation, a provision should be built-up over the useful life of the asset.

See paragraph 7.3.4 for the further recognition of the restoration costs under both of the previously mentioned alternatives.

7.3.3 Subsequent measurement

Tangible fixed assets should be measured after initial recognition at (DAS 212.401):

- cost (purchase cost or construction cost, as appropriate); or
- current value.

Article 2:384(1) NCC gives an option. The entity should choose the same accounting policy for each category of tangible fixed assets and apply it consistently (DAS 212.401). Thus, different accounting policy may be used for land and buildings, or for buildings and machinery, for example.

Cost
If after initial recognition a tangible fixed asset is measured at cost, the asset should be measured at cost less accumulated depreciation and impairment losses (DAS 212.402).

Current value
The current value of an asset means the monetary value of that asset given the nature and location of the activity for which the asset is intended at the time of determining that value. The determination of current value should be carried out with sufficient regularity to ensure that the carrying amount does not differ significantly from the current value on the reporting date (DAS 212.408). For the interpretation of the current value of tangible fixed assets - other than investments - current cost, value in use or net selling price (Article 7 BAW) are eligible, depending on the situation. Tangible fixed assets, other than investments, are valued at the lower of (1) current cost and (2) the higher of value in use and net selling price (Article 7 BAW) when current value is applied.

The Decree on current value (BAW) replaced the term 'replacement value' with the term 'current cost'. This change is applicable for financial years starting on or after 1 January 2016. Current cost means the current purchase or construction cost of the asset in question in the original condition in which it was acquired, less depreciation. Current cost looks at the asset owned by the entity. In contrast, replacement value looks at a replacement asset that has an economically equal significance. If a replacement asset differs from the current asset, adjustments must be taken into account in determining replacement value to the extent that the economic significance of the replacement asset differs from that of the current asset. For example, for differences in machine capacity.

The concept of current cost assumes technically identical replacement. In practice, however, technically identical replacement is often not possible. Therefore, it is difficult to determine the current cost of such assets. Partly for this reason, the Dutch Accounting Standards Board has included a transitional provision if an entity, due to the changed interpretation of current value, opts for a change in accounting policy, moving from measurement at current value to measurement at historical cost.

Change in accounting policy from 'current value' to 'historical cost'
If measurement was at current value (replacement value) up to and including 2015 and at historical cost with effect from 2016 or a later date as a result of the changed interpretation of current value, then it is permissible to recognise this change in accounting policy prospectively. This means that, in that case, the carrying amount at replacement value at the end of the previous financial year is taken as the starting point ('deemed cost') when applying the cost model from the year in which this change in accounting policy is applied (DAS 212.802). As a result, with this method of recognition, the change in accounting policy has no effect on opening equity.

DAS 212.803 then addresses the further recognition of assets carried at 'deemed cost'. Due to application of the cost model, (upward) revaluations no longer take place. The carrying amount continues to be depreciated in accordance with the cost model. Any existing revaluation reserve is released on realisation (i.e. through depreciation or possible disposal) and is recognised under the accounting policy already used by the entity (taken directly to Other reserves or in a separate item to the profit and loss account (DAS 212.415)). Although not specifically addressed by the Dutch Accounting Standards Board, we consider it acceptable in this situation that an impairment is also recognised under the accounting policy already used by the entity. This means that an impairment is charged to the revaluation reserve up to the amount included in the revaluation reserve in respect of the relevant asset (in accordance with the last sentence of Article 2:390(3) NCC, see also paragraph 10.4.1). In other words, only if the impairment exceeds the revaluation reserve of the relevant asset will the excess be recognised in the profit and loss account. This amount would also have been entered in the profit and loss account if the asset had been measured at its original cost.

Current cost
'Current cost' means current purchase or construction cost less accumulated depreciation (Article 2 BAW). The choice between current purchase cost or current construction cost should be consistent with how the entity acquired the asset (DAS 212.404). There are no concrete rules on how current cost should or can be determined. However, the manner in which the current cost was determined must be disclosed (Article 9 BAW). It can only be inferred from the regulations that the current purchase cost and current construction cost are determined based on market-based data (DAS 212.405).

The current purchase cost of an asset must be based on the amount that an entity would pay for that asset at the date of revaluation upon acquisition, if the asset were of the age as at the time of original acquisition, plus the estimated current incremental purchase cost. Therefore, if the entity did not originally acquire the asset in new condition, the current new value cannot be used. The current purchase cost of the asset as originally purchased should then be used (DAS 212.405).

Example: Current cost of property purchased

Company A bought an existing commercial property including land 10 years ago and measured it at current value. At the time of purchase, the property was 5 years old. The purchase price was 2,000,000, of which 500,000 was for the land and 1,500,000 for the property. These amounts include the additional costs of the buying agent, civil-law notary fees and transfer tax. A depreciates the property on a straight-line basis over 25 years with no residual value (4% per year). The accumulated depreciation on the property is therefore 40%. Land is not depreciated.

The current cost refers to the price that would have to be paid now for the same property with an age of 5 years, plus current additional costs and less accumulated depreciation of 40% on the current purchase cost of the property. The current purchase cost is normally determined using market-based data or through valuations by licensed valuers. The current purchase cost of the land can be based on the market value of the land in question (to be increased by current additional costs), as land has an infinite useful life.

Suppose the current purchase cost of the property is 1,750,000 and that of the land is 700,000, to be increased by 150,000 additional costs for the property and 50,000 for the land. The current cost of the property is then 1,140,000 (= 60% of (1,750,000 + 150,000)). The current cost of the land is 750,000 (= 700,000 + 50,000). The total carrying amount at current value is then 1,890,000 (= 1,140,000 + 750,000). The revaluation is taken directly to the revaluation reserve, less any provision for deferred taxes.

The current construction cost should be based on the costs that the entity would incur if the asset were constructed on the date of revaluation. Cost allocation, including the allocation system of any indirect costs and borrowing costs, must be consistent with the system as applied by the entity on the date of revaluation (DAS 212.405).

Example: Current cost of self-constructed property

Company A bought a plot of land 10 years ago and built its own business premises on it. Consequently, it is a self-constructed asset. A measures buildings and land at current value. The construction cost of the land was 505,000, comprising the purchase price (450,000), additional costs (50,000) and allocated interest (5,000). The construction cost of the buildings was 2,000,000, comprising direct costs (1,500,000), allocated indirect costs (450,000) and allocated interest (50,000). A depreciates the property on a straight-line basis over 25 years with no residual value (4% per year). The accumulated depreciation on the property is therefore 40%. Land is not depreciated.

Current cost refers to the current construction cost based on the cost if the property were now constructed by the entity itself, less accumulated depreciation of 40% on the current construction cost of the property. Consequently, the entity's system for allocating indirect costs and interest should be applied as it is on the date of revaluation, i.e. according to current standards and rates. The current construction cost of land can be based on the market value of the land in question (to be increased by current additional costs and allocated interest), as land has an infinite useful life. The revaluation is taken directly to the revaluation reserve, less any provision for deferred taxes.

The current purchase cost of commercial buildings, machinery and equipment and other tangible fixed assets is normally determined using market-based data or through valuations by licensed valuers. Information regarding purchase prices can usually be derived from one or more of the following sources (DAS 212.405):

- offers or enquiries from suppliers;
- recent transactions;
- indices from, for example, industry associations or statistical agencies; or
- expert valuations.

The determination of the current construction cost will be mainly based on internal cost calculations, where the sources listed above may also be relevant (DAS 212.405).

Current cost refers to the purchase side of the market. Therefore, the current cost can be determined by adjusting the new build value (if purchased in new condition) for depreciation, in accordance with the depreciation system based on the entity's expected useful life. Current cost is thus determined based on the useful life specifically expected by the entity. Therefore, based on the entity's depreciation system, accumulated depreciation must be adjusted proportionately to the change in the current purchase or construction cost (DAS 212.406). A change in the estimated useful life of the asset does not result in a change in current cost on the reporting date. This change does, however, affect future depreciation (see paragraph 7.4).

When determining the current cost, it is important to take into account the method of recognising subsequent expenditures, costs of restoration and/or costs of major maintenance. Depending on the recognition method, these costs may or may not form part of the purchase or construction cost. If these costs are part of the purchase or construction cost, a separate current cost must be determined for those components (DAS 212.407).

If the entity determines that it is no longer possible to reliably determine the current cost of the asset on the reporting date and expects this to be the case in the future, no further revaluations of the asset are made from that point onwards. In this case, the last determined current cost is depreciated over the remaining useful life. Because valuation remains at current value, the revaluation reserve is maintained (DAS 212.408).

Value in use
'Value in use' (also referred to as net realisable value) means the present value, at the time of measurement, of estimated future cash flows attributable to an asset or combination of assets that can be obtained from the operation

of the business (Article 3 BAW). The value in use is determined according to the principles of DAS 121.3. In short, this means assuming the future cash flows from the specific use of the asset and using a discount rate that reflects both current market interest rates and the specific risks of the asset in question. The value in use is thus determined based on the specific use of the asset by the entity. See also paragraph 10.3.2.

Net selling price
'Net selling price' (also known as direct realisable value) means the maximum amount at which an asset can be sold, less costs to be incurred (Article 5 BAW). See also paragraph 10.3.1.

Incidental revaluation
Based on the legislative history (Article 2:384 NCC), our interpretation is that an incidental revaluation or episodic revaluation is acceptable if there is a strong deviation between the carrying amount based on historical cost and the carrying amount based on current value. When Article 33(1)(c) of the Fourth EC Directive (78/660/EEC) was implemented in Dutch law, it was explicitly proposed to make incidental revaluation mandatory. The interpretation of letter c in terms of incidental revaluation follows from the history of the Fourth EC Directive. In the draft (1971), measurement based on replacement value and 'revaluation' were regulated in separate articles (30 and 31, respectively). The amended draft (1974) extended Article 30 to include a provision that other forms of current value could be used in addition to replacement value. The explanatory note to Article 30 noted: ‘The valuation methods envisaged by paragraph 1(b) are those whereby the trend in current value from one accounting period to another is regularly followed by and reflected in the annual accounts, as opposed to revaluation, as authorised by Article 3, which will take place only once in a while’ (Proposal for a fourth Directive on the annual accounts of limited liability companies, COM (71) 1232 final, 10 November 1971, Bulletin of the European Communities 12/71, Supplement 7/71). Article 2:384(5) NCC (draft) proposed by the Dutch legislator read: 'If the carrying amount of an asset is less than its current value by a non-negligible amount, additional information is disclosed in the notes that enables the formation of a responsible opinion on equity and profit or loss. The entity is obliged to revalue the asset at current value if, even when applying the previous sentence, the insight that the financial statements should give pursuant to Article 362(1) is seriously harmed by measurement at a value lower than current value.' Comments on the bill revealed 'a certain misunderstanding of the meaning', after which it was decided not to include this provision. Instead, Article 2:384(1) NCC included a reference to Article 2:362(1) NCC, which also referred to the application of incidental revaluations. This was thus intended to have the same effect as the then proposed text of Article 2:384(5) NCC, namely that incidental revaluations are carried out when the insight that the financial statements should provide under Article 362(1) NCC is seriously harmed by valuation at a value lower than the current value.

The characteristic of an incidental revaluation is that the current value is not always tracked year-on-year, but a revaluation is carried out only incidentally for the sake of a fair equity presentation. This means that there is no consistent measurement at current value, so in a formal sense there is no change in accounting policy. The accounting policy remains valuation at historical cost, albeit incorporating an incidental revaluation. Moreover, even in the case of an incidental revaluation - as with a systematic measurement at current value - revaluation must take place based on current value in accordance with the Decree on current value (BAW). This refers to the lower of (1) current cost and (2) the higher of value in use and net selling price (Article 7 BAW, see below under 'Current value').

Depreciation should of course be applied to the higher current value. In addition, a revaluation reserve must be formed for the recognised increase in value (Article 2:390(1) NCC) and it is preferable to recognise a deferred tax liability in conjunction with the revaluation (DAS 272.304).

In paragraph 7.6, we elaborate on the disclosure requirements for an incidental revaluation.

Impairments
Based on Article 2:387(4) NCC, an impairment loss must only be taken into account if it is expected to be permanent. According to the Dutch Accounting Standards Board, impairment when measured at cost occurs when the recoverable amount (the higher of value in use and net selling price) is less than the carrying amount. As the value-in-use calculation is based on future cash flows over the remaining useful life, the requirement that the impairment loss be sustainable is met (DAS 121.104).

When measuring tangible fixed assets at current value, current cost is applicable. Again, valuation is at the lower of (1) current cost and (2) the higher of value in use and net selling price. In fact, therefore, there is no difference between the valuation according to the cost model and the current value model in case of a write-down to lower recoverable amount.

Permanent impairment of fixed assets should be charged to the profit and loss account to the extent that it cannot be deducted from a revaluation reserve (Article 2:387(4) NCC). This means that the amount charged to the profit and loss account does not depend on the measurement basis 'historical cost' or 'current value'.

Accounting for a revaluation when measuring at current value
If tangible fixed assets, other than investments, are measured at current value, the value increase must be included in a revaluation reserve (Article 2:390(1) NCC). Revaluation reserves are recognised and held on an asset-by-asset basis. If the current value of an asset falls below its original purchase or construction cost (net of depreciation), the write-down will be charged to the profit and loss account. Netting within the revaluation reserve is therefore not allowed (see also Chapter 14). Any distinguishable individual asset should be deemed an asset. This means, for example, that the revaluation reserve must be recognised for each building. Recognising a deferred tax liability in conjunction with a revaluation is not required by law. However, the recognition of a deferred tax liability is strongly preferred (DAS 272.304).

Example: Current value below purchase cost

BV A bought a passenger car with a purchase cost of 50,000 on 1 January year 1. The car is depreciated on a straight-line basis over five years with a residual value of 10%. On 31 December year 1, the new price of the relevant model has fallen to 45,000 due to technological developments, with a residual value of 10% of this amount.

At the end of year 1, the carrying amount before revaluation is 41,000 (= 50,000 - 20% of 50,000 * 90%). The current cost is 36,900 (= 45,000 - 20% of 45,000 * 90%). When valued at current value, the car must be written down by 4,100 (= 41,000 - 36,900) to the profit and loss account. In addition, the price decline is an indication of impairment (DAS 121.203). A must therefore also estimate the recoverable amount for the car (see Chapter 10). This is regardless of whether A measures its cars at cost or current value.

Balance sheet measurement basis in relation to basis for determination of profit or loss
Application of the same accounting principles for the balance sheet and profit and loss account is preferred. In our opinion, it is acceptable under Article 2:390 NCC for the balance sheet to be prepared on the basis of historical prices and the profit and loss account on the basis of current values. In that system, the difference in depreciation represents realised revaluation and is recognised in Other reserves. Realised revaluation is not included in the revaluation reserve. The legislator's intention behind the revaluation reserve is not to preserve physical assets (substantialism), but capital protection. Article 2:390 NCC provides that the revaluation reserve may only consist of unrealised revaluations. The legislator deliberately chose this. The legislator explains that the method of release of the revaluation reserve as a result of realisation depends on the method of determining profit or loss (Explanatory Memorandum to draft bill 29737, no. 3, p. 23). This concerns an explanation by the legislator of the legal text of Article 2:390(3) NCC and applies to all assets and liabilities measured at current value. The law therefore allows the release of the revaluation reserve to be transferred to free reserves or to the profit and loss account.

If the balance sheet is prepared on a current value basis, depreciation should be based on current value.

The recognition of the release of the revaluation reserve depends on the objectives when applying current value. Indeed, different objectives may be in mind when applying revaluations, and significance should also be attributed to the valuation system chosen. The objective is significant for the recognition of the release of the revaluation reserve. If the objective is merely to provide a more faithful representation of the value of assets, the release of the revaluation reserve may be taken to the profit and loss account if such release is actually realised.

If the method of determining profit or loss is nominalistic ('nominal increases in equity are treated as profit'), releasing realised revaluations in the profit and loss account is acceptable. We believe that in that situation, release to profit or loss is the only acceptable method of recognition. If the method is substantialist ('profit is determined by eliminating asset price increases, thereby preserving physical capital maintenance'), it is not acceptable to account for the release of realised revaluations to profit or loss.

In the case of tangible fixed assets, therefore, measurement at current value can be done solely to provide a good understanding of the size of equity. The method of determining profit or loss can then be nominalistic. This can be achieved by recognising depreciation on a current value basis and crediting the realised revaluation to the profit and loss account (in accordance with Article 2:390(4) NCC in a separate item). Users of financial statements thus gain insight into both profit or loss on a current value basis and profit or loss on an historical cost basis.

Example: Valuation at current value and nominalistic determination of profit or loss

Private limited liability company A was incorporated on 1 January year 1. Upon incorporation, tangible fixed assets were acquired with a purchase cost of 2,000. The economic life of the TFA is 20 years. Residual value is estimated at zero.

A's balance sheet at end of year 1 reads:

	D	C
Tangible fixed assets	1,900	
Share capital		100
Other reserves		800
Liabilities		1,000
	1,900	1,900

A's profit and loss account for year 2 on a historical cost basis is as follows:

Sum of operating revenues		300
Depreciation TFA	100	
Other operating expenses	50	
Sum of operating expenses		(150)
Operating profit		150
Borrowing costs		(50)
Profit before tax		100
Tax expense		(25)
Profit after tax		75

The balance sheet at the end of year 2 based on historical costs would then look as follows:

	D	C
Tangible fixed assets	1,800	
Cash	200	
Share capital		100
Other reserves		800
Profit year 2		75
Debt		1,000
Tax debt		25
	2,000	2,000

Now suppose that due to special market developments, the current value of the TFA increases to 2,850 (950 increase in value over carrying amount) as of 1 January of year 2. A wishes to reflect this increase in value in its balance sheet and chooses as a basis to credit the realised revaluation to the profit and loss account. The remaining useful life of the TFA is 19 years as originally estimated and the residual value is still estimated at zero.

The balance sheet immediately after the revaluation as at 1 January year 2 then looks as follows:

	D	C
Tangible fixed assets	2,850	
Share capital		100
Revaluation reserve		712.5
Other reserves		800
Provision for deferred tax liabilities		237.5
Debt		1,000
	2,850	2,850

The increase in value (= unrealised revaluation) is then recognised on the balance sheet as follows:

	D	C
ΔV in TFA	950	
Revaluation reserve		712.5
Provision for deferred tax liabilities		237.5
	950	950

ΔV refers to the increase in value of TFA, used in its own operations, which is recognised directly in equity less a provision for deferred tax liabilities. The recognition of a deferred tax liability on revaluation is recommended by the Dutch Accounting Standards Board. In this case, the deferred tax is recognised at face value (assuming a tax rate of 25). The ΔV still included in the carrying amount of the asset is equal to the revaluation reserve (Article 2:390(3) NCC), taking into account the provision for deferred tax liabilities still shown as a liability in respect of this unrealised increase in value.

The profit and loss account for year 2 then looks as follows:

Sum of operating revenues		300
Depreciation TFA	150	
Other operating expenses	50	
Sum of operating expenses		(200)
Operating profit based on current value		100
Realised revaluation		50
Operating profit based on historical costs		150
Borrowing costs		(50)
Profit before tax		100
Tax expense		(25)
Profit after tax		75

Optionally, the realised revaluation can also be presented directly above borrowing costs but below the operating profit or loss. There are then no separate rules for 'Operating profit or loss based on current value' and 'Operating profit or loss based on historical cost' (DAS 240.411).

The realised revaluation of 50 includes the tax related to that realisation. The amount of 50 thus consists of a realisation of net revaluation of 37.50 (= 75% of 50 or 712.50 / 19) plus the associated tax of 12.50 (= 25% of 50 or 237.50 / 19). Thus, the reduction in the deferred tax of 12.50 was first recognised in the revaluation reserve and then the gross reduction in the revaluation reserve (50) was recognised in the profit and loss account. The tax amount associated with the reduction of the revaluation reserve is charged to profit or loss under the item taxation'. Under this method of recognition, there is a normal tax burden in the profit and loss account. This is in line with what is stipulated in DAS 240.411.

The balance sheet at the end of year 2 on a current value basis then looks as follows:

	D	C
Tangible fixed assets	2,700	
Cash	200	
Share capital		100
Revaluation reserve		675
Other reserves		800
Profit year 2		75
Provision for deferred tax liabilities		225
Debt		1,000
Tax debt		25
	2,900	2,900

The unrealised increase in value (ΔV) included in tangible fixed assets at end of year 2 can be broken down as follows:

	D	C
ΔV in TFA	900	
Revaluation reserve		675
Provision for deferred tax liabilities		225
	900	900

7.3.4 Changes in the size of the restoration costs after initial recognition

Paragraph 7.3.2 discussed that if the obligation to restore arises at the end of the useful life of the asset, as a result of the acquisition of the asset, a provision for restoration costs can be made in two ways (DAS 212.435):

a. as part of the asset's carrying amount; or
b. through the build-up of a provision for restoration costs over the asset's useful life.

In this section, we address how to account for changes in the size of the restoration costs per alternative.

Changes in the restoration cost as part of the asset's carrying amount
It is obviously to be expected that the estimated amount of restoration costs will be subject to change over the asset's useful life. Such changes in accounting estimates may be caused by, among other things, amended laws and regulations, or technological and price developments.

Changes in the obligation of the restoration costs are reflected in the carrying amount of the related asset. If there is a reduction in the restoration obligation that exceeds the carrying amount of the related asset, the amount in excess of the carrying amount must be recognised in the profit and loss account (DAS 212.439).

The recognition of changes in accounting estimates in the size of the restoration obligation does not depend on the measurement basis of an asset (cost or current value). In both the cost model and current value model, the restoration obligation (the provision for restoration costs) is based on current expectations. A change in this expectation is reflected in the asset's carrying amount in both models. This does not lead to a change in the revaluation reserve even when applying the current value model (DAS 212.440).

The appendix to DAS 212 includes an example illustrating the recognition of a change in the restoration obligation if the tangible fixed asset is measured at current value. The following example illustrates the recognition of a change in the restoration obligation if the tangible fixed asset is measured at cost.

Example: Changes in the restoration costs when recognising restoration costs as part of the asset's carrying amount

A company has acquired and commissioned a drilling platform that is due to be demolished at the end of its 40-year useful life. The acquisition value of the platform is 110.000. The estimated end-of-life cost of restoration (demolition) as a result of putting the asset in place is 712.200. The present value of this amount (calculated at a discount rate of 8% over a 40-year period) is 10.000.

After 10 years, the provision has accrued interest up to 21.500 and the asset is carried at 90.000 (=(110.000 + 10.000) x 30/40). Due to technological advances, it is estimated that the face value (over 30 years) of the restoration obligation is 40.200 less. Its present value is 4.000 (=40.200 / 1,08^30). The restoration obligation is reduced to 17.500 (= 21.500 – 4.000). The journal entry is then as follows:

Provision for restoration costs	4.000	
Drilling platform		4.000

The peculiarity of this entry is that part of the cost of the asset may be subject to change and is not actually fixed until the restoration obligation is known. The same type of entry should also be made, incidentally, if the change arises due to a change in the discount rate.

Changes in the restoration cost when recognised through the build-up of a provision for restoration costs over the useful life of the asset
Changes in the obligation for restoration costs that are recognised through the build-up of a provision should be recognised as a change in accounting estimate in accordance with DAS 145 (DAS 212.444). This means that such changes are recognised prospectively.

Example: Change in restoration costs when recognised through the build-up of a provision for restoration costs over the useful life of the asset

See data from preceding example. If the company recognises restoration costs through the build-up of a provision, and as a result of technological advances the final nominal obligation is estimated to be 40.200 lower, the annual addition to the provision will be reduced to 4,090 (= ((217.200 – 40.200) - 217,200 * 10/40) / 30)).

7.3.5 Retirement

Retirement means that the tangible fixed asset is no longer used in the entity's operations and also no longer generates revenue independently through the use of the asset's future performance units, other than through disposal of the asset. For example, if lease income is received through leasing of the asset, this is not classified as retirement (DAS 212.501).

At the time of retirement, the carrying amount of retired assets is not adjusted. However, depreciation must be stopped from the time of final retirement (DAS 212.427). In addition, retirement at an earlier time than expected is an indication of impairment (DAS 121.203). In this case, the recoverable amount (in this case the net selling price) must be estimated and any impairment recognised (see Chapter 10). If tangible fixed assets have been retired, impairment losses should be taken into account in the measurement (DAS 212.501).

7.4 Depreciation

7.4.1 General

Tangible fixed assets with a finite useful life should be depreciated separately (DAS 212.417). The periodic depreciation costs should be recognised in the profit and loss account, except when direct depreciation costs are recognised in the carrying amount of another asset produced by the entity (e.g. manufactured inventory).

7.4.2 Component approach

On acquisition of an asset, an asset should be distinguished into significant components. These are components that have a shorter useful life than the useful life of the total asset. A component is classified as significant if the cost of that component is significant in relation to the total cost of the total tangible fixed assets (DAS 212.418). These components are depreciated over their own useful lives from the time of acquisition (also referred to as the 'component approach') (DAS 212.418).

If a significant component is replaced, this is a replacement investment, regardless of whether the expenditure was originally classified as a significant component. The expenditure of the replacement investment is capitalised again as a component and depreciated over its useful life (DAS 212.206). A carrying amount of the component to be replaced may still remain at that time. That carrying amount is then recognised, as a disposal, as a charge to profit or loss (DAS 212.508).

An example is a production facility where cranes and hoisting systems are replaced (preventively) every 10 years. The production facility has a useful life of 30 years. On procurement of the production facility, the cranes and hoist systems are recognised as significant components because their cost is significant relative to the cost of the production facility. The production facility excluding the cranes and hoisting systems is depreciated over its useful life of 30 years. The cranes and hoist systems are depreciated over their 10-year useful life. When replaced after 10 years, the new cranes and hoist systems are recognised in the carrying amount of the production facility and depreciated over another 10 years. Any remaining carrying amount of the replaced components, for example if the replacement occurs earlier than planned, is removed.

The recognition method set out above is therefore important, on the one hand, because at initial recognition of a tangible fixed asset, significant components with a different useful life from (other components of) the total tangible fixed assets are distinguished and depreciated separately and, on the other, because if, after initial recognition, these significant components are replaced, they are recognised as a replacement investment. If the carrying amount of the replaced component cannot be practically determined, the cost of the replacement may be used as an indication (DAS 212.508).

A distinguishable component must meet the general capitalisation requirements (see paragraph 7.2). These are significant individual components. Non-significant components may be distinguished separately and depreciated, but this is not mandatory. The Dutch Accounting Standards do not prescribe exactly when a component is considered significant. So there is a degree of professional judgement that depends on the specific situation with the entity. Asset components are considered significant if they are distinguishable from each other and differ in useful life. This requires careful consideration of facts and circumstances.

7.4.3 Other aspects of depreciation

Depreciation method
The depreciation method should be based on the expected pattern of use of the asset, in line with the use of future performance units of the asset (DAS 212.423). A significant change in the expected pattern of use should lead to adjustment of the depreciation method. The Dutch Accounting Standards Board does not prescribe one particular depreciation method, but instead lists several possible systems, such as straight-line depreciation, a degressive depreciation or depreciation based on units consumed. Straight-line depreciation results in a constant charge over the useful life if the residual value does not change. With degressive depreciation, depreciation decreases annually. The depreciation method based on units consumed results in an expense based on expected use or production. For the choice of method, it is only relevant that the reduction in the used performance capability of the asset match as closely as possible. A change in the depreciation method should be recognised as a change in accounting estimates in accordance with DAS 145 (DAS 212.424) (see Chapter 3). The choice of depreciation method does not take into account how the asset is financed. For example, an annuity-based depreciation method is almost never appropriate for determining the expected usage pattern of the asset.

Start and end of depreciation
Depreciation should start when the asset is available for its intended use. Depreciation should end when the asset is permanently retired or when the asset is disposed of (DAS 212.427).

Depreciation of the asset takes place until the residual value is reached and as long as the asset has not been permanently withdrawn from use, even if the net selling price of the asset exceeds its carrying amount (DAS 212.429).

Depreciation of spare or maintenance parts
The factual circumstances indicate whether spare and maintenance parts are depreciated, as long as they are not (yet) in use. For example, depreciation occurs if the useful life decreases regardless of whether the spare and maintenance parts are being used or not (DAS 212.427).

Depreciation at current value
If measured at current value, depreciation should also be based on this current value. For the treatment of realised revaluation, please refer to what is included in paragraph 7.3.2 in this regard.

Change in useful life and residual value
Useful life means (DAS 940):

- the period during which an asset is expected to be available for use by an entity; or
- the number of production or similar units the entity expects to obtain from the asset.

The residual value of an asset is the amount that an entity would currently receive for the asset on disposal, after deducting estimated disposal costs, if the asset were already of the age and in the condition expected at the end of its useful life (DAS 940). The useful life and/or residual value of an asset should be reassessed only if changes in circumstances occur or new information becomes available regarding its remaining useful life and/or residual value (DAS 212.428). In determining useful life, factors other than just usage should also be taken into account (DAS 212.432). The following factors are considered in determining the useful life of an asset (DAS 212.433):

- the expected use of the asset;
- the expected physical wear and tear;
- technical or economic obsolescence resulting from changes or improvements in production, or from a change in market demand for the product or service provided by the asset; and

- legal or similar restrictions on the use of the asset, such as expiry dates of related lease contracts.

Land and buildings are recognised separately as they are assets that can be separated even if acquired jointly. In principle, land is not depreciated as it has an infinite useful life. Exceptions include quarries and landfill sites. Buildings have a finite useful life and are therefore depreciable assets. This applies even if the value of the building has increased. Similarly, an increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

If the expected useful life and/or residual value in respect of a tangible fixed asset change, changes in accounting estimates come into play. It may not be recognised retrospectively (as a lump sum with retroactive effect), but should only affect the current year's depreciation and the remaining useful life. See also Chapter 3 on the recognition of changes in accounting estimates. This applies to both an extension and decrease of useful life. In the case of a decrease of useful life, a charge may not be recognised as a lump sum, unless of course there is an impairment.

Tax legislation related to depreciation
For buildings, tax depreciation options are limited. This tax legislation does not affect the fact that the useful life and residual value should be determined for the financial statements in accordance with the principles of DAS 212. Tax legislation does not affect those assumptions. As a result, deductible temporary differences may arise. In principle, these lead to deferred taxes. For the recognition and measurement of deferred taxes, see Chapter 17.

7.5 Disposal and exchange of tangible fixed assets

Disposal of tangible fixed assets
A tangible fixed asset is derecognised after sale or when no future units of performance are expected from its use or sale (DAS 212.505). The destruction of the asset is considered a disposal. For example, as a result of demolition. The income or expense arising from the disposal of a tangible fixed asset should be recognised in the profit and loss account when the item is derecognised (DAS 212.506). Such income is not normally recognised as part of net revenue. However, the Dutch Accounting Standards Board recommends that regularly recurring sales of tangible fixed assets be recognised as part of net revenue (DAS 270.201). This applies, for example, to regular car sales by leasing and rental companies. The carrying amount of the assets sold is then recognised as an expense.

For disposals not recognised under net revenue, the gain or loss on disposal should be determined as the difference between the net revenue, if any, on disposal and the carrying amount of the asset (DAS 212.509). Furthermore, any provision to be formed as part of the transaction must be taken into account. Indeed, there may be cause for the recognition of such a provision if the sales transaction involves a legally enforceable or constructive obligation. See Chapter 16.

Of course, assessing the acceptability of the recognition of profit or loss on sale requires assessing the economic reality of the contract terms as a whole. This economic reality may mean that no transfer of any, or virtually any, economic benefits and risks has taken place, but that financing is involved. The criteria for recognising a gain are applied to the totality of related transactions if these transactions are so related that they can only be understood in context (DAS 270.109). For example, an entity may sell things and at the same time agree (possibly in a separate contract) that those things will be repurchased at a later date, or the selling entity gives a put option to the buying party in such a way that the selling entity essentially retains the significant economic risks (e.g. residual value risk). In that case, it is not acceptable to recognise profit or loss on the transaction. See also paragraph 26.7 on the recognition of sale transactions with repurchase contracts.

Exchange of tangible fixed assets
An exchange of tangible fixed assets normally results in the recognition of a gain if the fair value of the exchanged asset exceeds its carrying amount. The asset acquired in the exchange is then recognised at the fair value of that asset. This is only not the case if items are exchanged that are similar in nature and value. A characteristic of such an exchange is that nothing or virtually no additional payments are made in cash. Then, the exchange is not considered a revenue-generating transaction (DAS 270.108). No revenue is then recognised and the asset acquired on exchange is recognised at the carrying amount of the exchanged asset.

DAS 212.309-311 includes specific provisions for determining the cost of tangible fixed assets in exchange transactions. If a tangible fixed asset is acquired in exchange for a non-monetary asset, the cost of such tangible fixed asset should be measured at fair value, but only to the extent that (DAS 212.309):

- the exchange transaction results in a change in economic conditions; and
- the fair value of the asset acquired or asset given up can be measured reliably.

Whether an exchange transaction results in a change in economic conditions is determined by assessing whether and to what extent future cash flows are expected to change as a result of the transaction. An exchange transaction results in a change in economic conditions if (DAS 212.310):

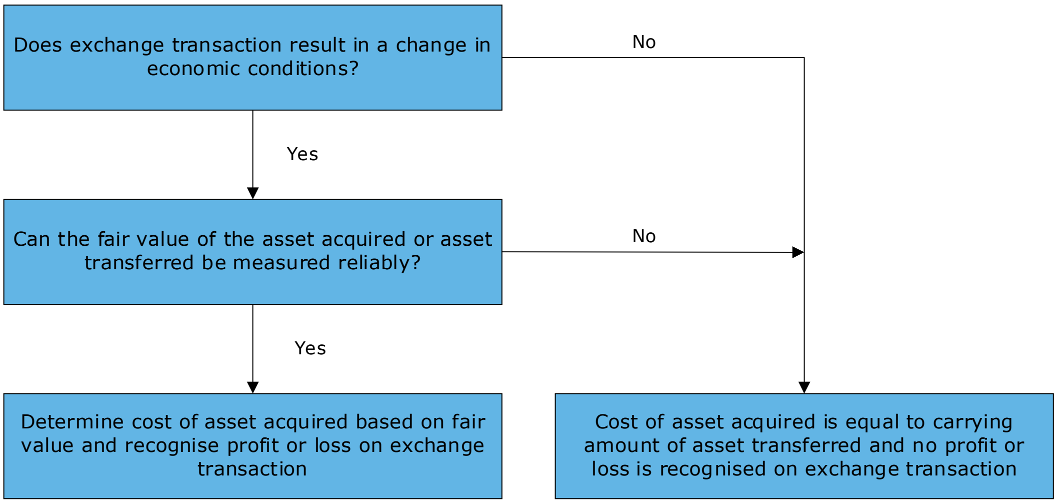
a. the composition (risk, timing and amount) of the cash flows from the acquired asset differs from the composition of the cash flows from the transferred asset; or
b. the value in use of the part of the business activities affected by the transaction changes as a result of the exchange; and
c. the differences under a. or b. are significant in relation to the fair value of the assets exchanged.

The value in use of the part of the business activities affected by the transaction is based on cash flows after tax. In most cases, it will be reasonably straightforward, without detailed calculations, to establish that the value in use has changed. An exchange transaction can take place, for example, through land consolidation. As a result of the changed availability of assets (e.g. agricultural land), operations can be conducted more efficiently, making the composition of cash flows, the value in use of the part of business activities and the differences in relation to the fair value of the assets exchanged important. If both the fair value of the asset acquired and the fair value of the asset transferred can be measured reliably, then the fair value of the asset transferred is used to determine the cost of the asset acquired, unless the fair value of the asset acquired is more clearly established (DAS 212.311). If the fair value of an asset cannot be derived from comparable market transactions then the fair value is considered reliable if (DAS 212.311):

- there are no significant deviations from available reasonable fair value estimates; or
- the probability of available estimates can be considered reliable for estimating fair value.

If the acquired or transferred tangible fixed assets cannot be measured reliably at fair value, cost is equal to the carrying amount of the transferred asset(DAS 212.309).

Diagram: Determining cost of exchange transactions of tangible fixed assets



7.6 Presentation and disclosure

Presentation
Tangible fixed assets should be classified into the following items (Article 2:366(1) NCC):

- land and buildings;
- machinery and equipment;
- other fixed assets;
- fixed assets under construction and prepayments on tangible fixed assets;

- tangible fixed assets not supporting the production process.

It is recommended to provide a further breakdown of classes included above, if this will give a better understanding of the composition of the carrying amount and invested amounts (DAS 212.601).

Production process means any fulfilment of a function in the conduct of business. Reserve capacity supports the production process.

Tangible fixed assets not supporting the production process include, for example (DAS 212.603):

- buildings exclusively for social and cultural purposes (e.g. management and staff housing);
- housing located on or near the entity's premises and necessary for the performance of staff duties is included in buildings;
- tangible fixed assets previously used in the business process, the use of which has been discontinued; and
- tangible fixed assets held as investments (investment properties).

Accounting policies
The notes should include the following information for each class of tangible fixed assets (DAS 212.701):

- the measurement bases for determining cost and/or current value;
- the method of recognising costs of major maintenance;
- the method of recognising costs of restoration;
- the depreciation methods used;
- the useful life or depreciation rates applied; and
- if interest on debt has been capitalised as part of cost, the interest capitalised during the reporting period.

Movement schedule
The movement of each of the items belonging to tangible fixed assets is presented in a movement schedule (Article 2:368(1) NCC). If significant movements have occurred during the reporting period, this should be shown in the movement schedule. In addition, the following information is provided for each item (Article 2:368(2) NCC and DAS 212.702):

- cost and current value respectively, at the beginning and end of the period;
- the sum of depreciation and impairment losses at the beginning and end of the period; and
- the sum of revaluations relating to assets present on the reporting date at the beginning and end of the period.

The movement schedule shows a reconciliation between the carrying amount at the beginning and end of the period, with separate disclosure of (DAS 212.702):

- investments;
- disposals;
- acquisitions through mergers and acquisitions;
- revaluations, if measurement takes place at current value;
- impairment losses;
- reversals of impairment losses;
- depreciations;
- differences from foreign currency translation; and
- other movements.

The Dutch Accounting Standards Board recommends including comparative figures from the previous financial year in the movement schedule if that is important to gain an understanding of the item in question (DAS 110.127).

Other disclosure requirements
The following information is included in the notes (if applicable) (DAS 212.703):

- the existence and nature of restrictions on property;
- tangible fixed assets serving as security for liabilities;
- expenditures recognised in the carrying amount of tangible fixed assets under construction;

- the amount of contractual investment obligations on tangible fixed assets;
- compensation from third parties for tangible fixed assets that were impaired, lost or given up, which has been recognised in the profit and loss account;
- the total expected amount of the cost of restoration, if the cost of restoration is recognised through the build-up of a provision; and
- the revenues and related expenses recognised in the profit and loss account, as well as the profit and loss account items in which these amounts are included, if the alternative recognition method is used for the recognition of sales revenues from produced material where an asset is not yet in the location and condition necessary for its intended use.

If tangible fixed assets are measured at current value, the following note should be included (DAS 212.705):

- the year of the most recently applied revaluations;
- any involvement of an independent valuer;
- the methods and significant assumptions applied in estimating the current value;
- the extent to which current value has been derived directly from observable prices in an active market or from recent market-based transactions, or has been estimated using other measurement techniques;
- the sum of revaluations at reporting date (for each class of tangible fixed assets);
- the carrying amount of tangible fixed assets for which the entity determines and expects that it is no longer possible to determine the current cost reliably; and
- the method of recognising realised revaluations.

If the current cost of an asset is no longer reliably determinable, this should be disclosed in the notes, stating the reason.

It should be disclosed how the current cost, value in use or net selling price was determined (Article 9 BAW).

If the market value of tangible fixed assets differs significantly from the carrying amount, consideration should be given to whether the market value should be disclosed in the notes, if this is necessary for the understanding of the financial statements (DAS 212.707).

The following information may also be relevant to users of financial statements and its disclosure is recommended by the Dutch Accounting Standards Board (DAS 212.707):

- the carrying amount of tangible fixed assets temporarily out of use;
- the gross carrying amount of any fully depreciated tangible fixed assets still in use; and
- the carrying amount of tangible fixed assets retired and held for disposal.

Disclosure requirements relating to costs of major maintenance through provision for major maintenance
If costs of major maintenance are recognised through a provision for major maintenance, the following disclosures should be made for this category of provision:

a. the measurement bases;
b. a brief description of the nature of the provision;
c. if necessary for the provision of adequate information, the principal assumptions and uncertainties; and
d. a movement schedule of the provision for major maintenance showing the principal movements.

Pursuant to Article 2:374(3) NCC, the extent to which (the total of) the provisions should be considered non-current is indicated as far as possible. In case of uncertainty as to when costs are expected to be incurred or payments made, a reasonable choice should be made as to whether the provision is non-current or not.

It is recommended to separately disclose the portion of provisions expected to be settled within one year and the portion of them expected to be settled after more than five years. This disclosure may be included as part of the notes to other provisions.

Disclosure requirements relating to incidental revaluation
An incidental revaluation should be disclosed in detail. This should be in line with the disclosure requirements relating to a change in accounting policy (despite, as explained in paragraph 7.3, not being a change in accounting policy in a

technical sense). Also, the disclosure requirements of DAS 212.705 (see above) must be followed. This includes disclosing the scope of the unrealised revaluation to establish the carrying amount that would have been recognised if no incidental revaluation had taken place (DAS 212.705(e)). The basis of recognition of the realised revaluation (DAS 212.705(g)) should also be disclosed. In addition, the accounting principles must indicate that an incidental revaluation has taken place (Article 2:384(5) NCC).

Furthermore, in our opinion, the reason an incidental revaluation took place should be disclosed and its impact on equity and profit or loss should be given. Art. Indeed, article 2:362(4) NCC requires that, if necessary for the required insight, the entity provide additional information. The impact on equity will generally correspond to the amount of the outstanding (unrealised) revaluation whose disclosure is already required under DAS 212.705. Regarding the impact on profit or loss, in addition to disclosing the basis of recognition for the realised revaluation (DAS 212.705(g)), it will also be necessary to disclose what the depreciation would have been if no incidental revaluation had taken place. These disclosures regarding impact on equity and profit or loss must also be made in the years following the incidental revaluation. The impact of the higher depreciation basis on profit or loss and equity is thus made visible to the user of the financial statements.

Disclosure requirement relating to change in accounting policy from provision for major maintenance to component approach
The DASB has included a transitional provision for a change in accounting policy whereby costs of major maintenance are no longer recognised through a provision for major maintenance, but are recognised using the component approach (see paragraph 7.3.2). If this transitional provision is applied, its application should be disclosed in the financial year in which the transition is recognised (DAS 212.807).

Disclosure requirements relating to change in accounting policy from 'current value' to 'historical cost'
If an entity has applied the transition provision whereby a change in accounting policy from current value to historical cost is recognised prospectively (see paragraph 7.3.2), the application of this transition provision should be disclosed in the financial year in which the transition is recognised, as well as in subsequent financial years as long as the revaluation reserve is not fully realised. The entity should separately disclose the amount of the related unrealised revaluation (DAS 212.804).

7.7 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

Pursuant to Article 2:396 NCC, small entities are exempt from the breakdown into classes of tangible fixed assets (Article 2:366 NCC). Therefore presenting tangible fixed assets as a single item is permitted,

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

7.8 Significant differences from IFRS

Costs of restoration
IAS 16 'Property, Plant and Equipment' states that the costs of restoration after the end of the use of tangible fixed assets should be included in the cost to the extent that these costs qualify for recognition under IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' and do not result from the use of tangible fixed assets to produce inventory. DAS 212 'Tangible fixed assets' also allows the recognition of a provision for such restoration costs to be charged to profit or loss over the expected useful life of the asset.

Major maintenance
Under IAS 16, if certain conditions are met, the costs related to major maintenance (periodic inspection, overhaul and refurbishment) should be capitalised as a separate component of tangible fixed assets. Under IAS 37, the recognition of a provision for major maintenance is not permitted. IAS 16 and IFRS 16 'Leases' (in the case of right-of-use assets with lessees) require (under certain conditions) that costs of major maintenance be capitalised as a separate component of the asset (component approach).

If an entity has determined that an amount is not related to the replacement of a significant component of a tangible fixed asset or frequent maintenance costs (see paragraph 7.2.2) but rather major maintenance, the Dutch Accounting

Standards allow the recognition of a provision for this amount of major maintenance pursuant to Article 2:374(1) NCC Pursuant to that article, provisions may be recognised against expenditures to be incurred in a subsequent financial year, to the extent that the incurrence of such expenditures also originates before the end of the financial year and the provision serves to spread expenses evenly over a number of financial years.

Revenues from sales of produced material
IAS 16 states that, until an asset is in the location and condition necessary for its intended use, the revenues from sale and related costs of equipment produced should be recognised in the profit and loss account. DAS 212 also allows net revenues from the sale of produced material to be deducted from the cost of the asset (DAS 212.303).

Application of current value model
When applying the current value model, subsequent valuations under IFRS are based on fair value as defined in IFRS 13 'Fair Value Measurement'. Under DAS 212, subsequent valuations are determined on a current cost basis.

Incidental revaluation
Based on the legislative history, our interpretation is that under NL GAAP, an incidental or episodic revaluation is acceptable if there is a strong deviation between the carrying amount based on historical cost and that based on current value. Under IFRS, it is not possible to recognise an incidental revaluation when measuring at cost.

Assessing useful life and residual value

IAS 16 states that at least at the end of each year, the useful life and residual value of an asset should be assessed. DAS 212 states that the useful life and residual value should only be reassessed if there are changes in circumstances or new information becomes available regarding the remaining useful life and/or residual value.

Sale of assets held for lease
IAS 16 states that for entities that routinely sell tangible fixed assets previously held for lease, these assets should be reclassified to inventory at the carrying amount at the end of the lease period. Sales revenues should then be recognised as net revenue in accordance with the provisions of IFRS 15 'Revenue from Contracts with Customers' on the sale of goods. DAS 212.506 recommends recognising regularly recurring sales of tangible fixed assets as part of net revenue.

Compensation for impairment or loss of assets
Under DAS 212.455, compensation from third parties that is related to the impairment or loss of an asset is recognised in profit or loss when the receipt of the compensation is probable. IAS 16 requires that the compensation is 'receivable'. This seems to be a stricter requirement, that is also in line with the strict criterion in IAS 37 regarding the recognition of a contingent asset in the balance sheet. Thus, under NL GAAP, such consideration will be recognised in the balance sheet earlier than under IFRS.

Assets held for sale
IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" requires that fixed assets, including tangible fixed assets, the disposal of which is highly probable, be presented on the balance sheet in a separate item under current assets as "held for sale". This presentation takes place from the moment the held-for-sale criteria are met. Valuation of assets held for sale (and disposal groups held for sale) is at the lower of carrying amount and net selling price (fair value less selling costs). Tangible fixed assets classified as held for sale, or belonging to a disposal group classified as held for sale, are no longer depreciated from the time they are classified as held for sale, not even if they are still in use. NL GAAP does not include presentation and measurement requirements for assets and disposal groups held for sale. Unlike IFRS 5, the BMJ does not permit such a method of presentation on the balance sheet.

8 Investment property

8.1 Introduction

Definition and scope
Investment property is defined as property, or part of property, held (by the owner or by a lessee under a finance lease) to earn rental income and/or for capital appreciation, and not for:

a. use in the production or supply of goods or services or for administrative purposes in the ordinary course of business; or
b. sale in the ordinary course of business (DAS 213.0).

The Dutch Accounting Standards Board gives the following examples of investment property:

- land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business;
- land held for a currently undetermined future use (if an entity has not determined that it will use the land for own use or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation);
- a building owned by the entity (or made available to the entity under a finance lease) and made available to others under an operating lease;
- a building that is vacant but is held to be made available to others under an operating lease; and
- property that is being constructed or developed for future use as an investment.

Investment property is dealt with in DAS 213 and is distinct from property (or rights of use) that does not meet the definition of investment property. We have summarised this in the table below:

Nature of the property / right of use	Description (including applicable DAS chapter)	Discussed in this manual in:
Property owned for own use	This refers to property held for use in the production or supply of goods or services or for administrative purposes in the ordinary course of business (DAS 212).	Chapter 7 Tangible fixed assets
A right of use under a finance lease in own use	Such as property owned for own use, e.g. offices or production sites that are leased and classified as finance leases (DAS 292).	Chapter 22 Leases
Property that is being constructed or developed for third parties	Does not meet the definition of investment property because it is developed for third parties (DAS 221).	Chapter 12 Construction contracts for third parties
Property held for sale in the ordinary course of business	This may be constructed by property developers who build "for inventory" (i.e. not on the instructions of third parties), in which respect the sale of property developed in-house is part of the ordinary course of business (DAS 220).	Chapter 11 Inventories
Property that is being developed for sale in the ordinary course of business	See above. These are the projects that are still being developed and that are not agreed with third parties, i.e. these, too, will be held as inventory (DAS 220).	Chapter 11 Inventories

Mixed-use property
Property can only be classified as investment property if it is not property for own use. Property may be partly leased and partly in use by the owner, such as a unit in an industrial building or specific office floors. The parts of this property that is not intended for own use that can be sold separately either in a direct sales transaction or by means of a finance lease are classified as investment property. The property does not classify as investment property if a

separate sale is ruled out, unless the part that is intended for own use only represents an insignificant part of the entire property (DAS 213.108).

The dividing line is not clear-cut in all cases. DAS 213.111 illustrates this with an example of a property operated as a hotel, where the owner's other involvement in the use is decisive. If the owner acts as an investor only, the property may be investment property. If the owner is also financially involved in the operation of the hotel, the activities are generally to be regarded as hotel operation and the property does not classify as investment property. It is clear that many intermediate forms are possible here. Similar hybrid forms can be found, for example, in the hospitality and leisure industries, car park operation and property used by self-storage companies (storage space for private individuals). An entity where this mixed use occurs will have to draw up rules for consistent classification.

Example: Property held for multiple purposes

A hotel owner owns a considerable number of buildings and wants to increase revenue by letting the rooms. Can the company classify these buildings as investment property?

No, it cannot. The building is intended for the activities carried out in the ordinary course of business, which is operating a hotel. Although the company holds the buildings partly for long-term capital appreciation, this is not the fundamental reason for holding the buildings.

Making available to and use by another group entity
In some cases, an entity owns a property that is made available to and used by the parent entity or another group entity within the group to which both entities belong. In the consolidated financial statements, the property is not investment property as, from the group perspective, the property is intended for own use.

If the parent entity owns the property and makes it available to a consolidated subsidiary for its own use, the property is classified as property for own use in the parent entity's company-only financial statements (DAS 213.113). This is because it is quite conceivable that re-leasing within the group does not involve, and does not need to involve, an investment property as defined in DAS 213. This could be the case if the lessor entity does not so much aim to hold the property for investment purposes, but wishes to make it available primarily for the activities carried out by the group. While the lease suggests the existence of investment property, in this situation it is subordinate to making the property available in accordance with the group policy based on own use.

In our view, this also holds true if a group entity other than the parent entity owns the property and makes it available to another group entity for its own use. However, from the perspective of that entity (not being the parent entity), the property is leased to a third party, which is a group entity. In that case, DAS 213.113 states that this entity (not being the parent entity) recognises the property in the company-only financial statements as investment property if it meets the definition of investment property. In other words, if this entity (not being the parent entity) does not hold the property for investment purposes, it will be regarded as intended for own use in this entity's financial statements as well. Even in this situation, the lessor entity may not so much aim to hold the property for investment purposes, but may wish to make it available primarily for the activities carried out by the group.

Example: Property leased out within the group

Entity A heads a group that owns a few research centres in addition to office space. For tax and legal reasons, the property is placed in a property company (P) and re-leased to sister entities at arm's length rates. Parent A considers the property to be intended for its own use as it does not hold the property placed in P for any investment purpose. The property primarily serves the group's strategic and operational policies. The reason for charging arm's length rates is mainly related to creating a level playing field compared to a situation where the property is leased from third parties and thereby imposing financial discipline on the group. In P's financial statements, the property is classified as intended for own use. This classification also underlies the measurement of the participating interest in P in A's company-only financial statements (net asset value). And, of course, the property is recognised as intended for own use in A's consolidated financial statements, too.

If a consolidated subsidiary owns the property and that subsidiary is measured in the parent entity's company-only financial statements using the net asset value method, in determining the carrying amount of the consolidated subsidiary the property held by the subsidiary is classified as property for own use in accordance with the classification applied for the consolidated financial statements. As a result, no differences arise between equity according to the consolidated financial statements and equity according to the parent entity's company-only financial statements (DAS 213.113).

Rights to use property that a lessee classifies as operating leases
DAS 213.102 allows a right to use property that a lessee classifies as an operating lease (e.g., leasehold land) to be recognised by the lessee as investment property, if and to the extent that this right to use the property meets the definition of investment property and the lessee uses the fair value measurement principle for the relevant asset in accordance with DAS 213.503-514. The lessee applies this alternative recognition method to all rights to use property that the lessee classifies as operating leases and that qualify as investment property. Specific disclosure requirements apply if this alternative recognition method is used. See paragraph 8.5.4.

When a right to use property that a lessee classifies as an operating lease is initially recognised as investment property by an entity, this represents a change in accounting policies. The property is recognised in accordance with DAS 140.208 and is also subject to the following provisions (DAS 213.901):

- if the entity has previously disclosed the fair value of this investment property in prior periods - in the financial statements or otherwise - the entity is advised to restate the comparative figures. The recognition method chosen is disclosed; and
- if the entity has not previously disclosed - in the financial statements or otherwise - the fair value of this investment property in prior periods, the entity does not restate the comparative figures and discloses this in the notes.

8.2 Recognition

8.2.1 General

Investment property is recognised when it is probable that future economic benefits will flow to the company and the cost of the asset can be measured reliably (DAS 213.201). The existence of the future benefits is determined at the time the asset is acquired and, therefore, at initial recognition, based on the circumstances at the time.

8.2.2 Beneficial ownership versus legal title

As is the case for tangible fixed assets, it is the beneficial ownership rather than legal title that is decisive in determining whether recognition must take place. Here, too, finance leases lead to capitalisation, with simultaneous recognition of the lease liability (DAS 213.102). If the entity has beneficial ownership but not legal title, this must be disclosed in the notes to the balance sheet (Article 2:366(2) NCC).

8.3 Measurement

8.3.1 Measurement at initial recognition

At initial recognition, investment property is measured at purchase cost including transaction costs (DAS 213.301). The purchase cost of property consists of the purchase price and all other costs directly attributable to the acquisition, which may include transfer tax, consultancy fees, civil-law notary fees and valuation costs. For self-constructed investment property, the purchase cost is determined based on the costs spent from the commencement of construction to the date when the construction or development is complete (DAS 213.303). The construction cost comprises all direct costs and may include a reasonable portion of the indirect costs and the interest on debt for the period of construction (Article 2:388(1) NCC). The inclusion of indirect costs in the construction cost will have to be disclosed in the notes. The transfer between the categories is discussed in more detail in paragraph 8.4.

The construction cost does not include losses due to low occupancy in the initial phase of operation or special costs such as the correction of errors or costs resulting from changes in designated use incurred during development. For example, the designated use of a property may change even during the development phase, such as from office building to hotel. In this case, additional costs or costs that would not normally have been incurred for the construction of a hotel are not part of the construction cost of the investment property.

Property can be considered a qualifying asset (a significant amount of time is required to make it ready for use or sale), which means that interest may also be capitalised in the purchase cost or construction cost. This is subject to the standard criteria and conditions applicable to interest capitalisation (see also Chapter 27).

Example: Start-up costs associated with investment property

Company A bought a building for 95 million in March of year 1. The building classifies as an investment property. In June of that year, A completely refurbished the building at a cost of 5 million in order to bring it to such a level that it can be leased in the office market. A will pay an estate agent a fee in the amount of two months' rent if the agent finds a lessee. From December of year 3, A (the lessor) eventually leases the building to B (the lessee) under an operating lease.

Can A capitalise the cost of the refurbishment and the fee payable to the estate agent?

On the day of acquisition of the building, A must recognise the building as investment property in accordance with DAS 213. The refurbishment costs are necessary to bring the building into the condition needed for the purpose that management has in mind for the building. Therefore, these costs are capitalised.

The agent's fee is regarded as initial direct costs incurred to generate revenue from the operating lease. These are either allocated to the lease term and offset against the lease income or charged directly to the profit and loss account (DAS 292.315).

Initial measurement of an operating lease classified as investment property
The initial measurement of a right to use property that the lessee classifies as an operating lease and treats as investment property must be recognised as a finance lease. This means that the asset is measured at the lower of the fair value of the property at the inception of the lease contract and the present value of the minimum lease payments. A corresponding amount must be recognised as a liability (DAS 213.306).

8.3.2 Expenditures after initial recognition

Expenditures after initial recognition must be recognised as part of the cost of the investment property if they meet the general recognition criteria (DAS 213.401), i.e. that capitalisation must take place if (DAS 213.201, see also paragraph 8.2.1):

- it is probable that future economic benefits will flow to the company; and
- the costs of the asset can be reliably determined.

Consequently, it is no longer required that these expenditures are expected to result in an increase in the economic benefits of the investment property and that the economic benefits exceed the level taken into account at the time of the previous measurement. This is because the general recognition criteria are met if the expenditures are economically viable.

8.3.3 Subsequent measurement

For investment property, either of two measurement methods may be used for subsequent measurement (DAS 213.501):

- historical cost;
- current value.

This choice is not made for each property separately, but for the entire category of investment properties. An exception exists if the fair value of a particular property cannot be reliably determined (see paragraph 8.3.5).

Incidentally, it is prescribed that in the case of measurement at historical cost, the notes must include the current value (DAS 213.502). As a result, data on both measurement methods will generally be available.

Historical cost
If measured at historical cost, investment property is recognised at purchase cost or construction cost, less accumulated depreciation. Impairments must also be taken into account (Article 2:384(1) NCC). See Chapter 10 for a discussion of impairments. Measurement at historical cost is subject to the provisions of DAS 212 (see Chapter 7).

Current value
The current value of an investment property is its fair value (called "market value" in the BAW) (DAS 213.503). "Fair value" is defined as the amount for which an asset can be traded between knowledgeable, willing parties in an arm's length transaction (Article 4 BAW). It is recommended that the fair value be determined on the basis of a valuation by an independent and expert valuer (DAS 213.502). If measured at fair value, the investment property is not depreciated.

The fair value of investment property must reflect the current market situation and conditions at the reporting date rather than at any past or future date (DAS 213.507).

The condition of the property partly determines the value if it is measured at fair value, which implies that measurement at fair value precludes the recognition of an additional provision for major maintenance (DAS 213.403). This is because it leads to double counting as, in addition to the provision for major maintenance formed, the state of repair was also taken into account in determining the fair value.

As the fair value is therefore a value based on transactions. The most obvious and objective comparative material for determining a fair value will be recent comparable transactions. These will be available particularly in a market where a relatively large number of similar properties are traded, as is the case, for example, with residential properties. Where the number of comparable properties is lower, this information will be relatively scarce. Multiple types of information will then be involved in a valuation that may or may not be independent. This information may include:

- rental income;
- the quality of the lessees;
- the remaining term of current lease contracts;
- market interest rates;
- market expectations; and
- prevailing rents (per square metre or otherwise) for comparable properties.

The fair value is determined based on the estimated transaction price obtained if the property were actually sold. This value must be determined at the reporting date and does not include transaction costs. The present value of the estimated future cash flows can be used to approximate the fair value (market value) (Article 11(1) BAW).

In determining the fair value of investment property, an entity avoids double counting assets or liabilities that are recognised separately in the balance sheet. For example (DAS 213.510):

- equipment, such as lifts or air-conditioning, is often an integral part of a building and is generally considered an inseparable part of the investment property rather than a separate tangible fixed asset;
- if an office is leased on a furnished basis, the fair value of the office also includes the fair value of the furniture, because the rental income relates to the furnished office; if furniture is included in the fair value of the investment property, that furniture is not regarded as a separate asset item; and
- the fair value of investment property excludes prepaid lease instalments or lease instalments received in advance, because the entity regards them as separate liabilities or asset items.

8.3.4 Movements in value and revaluation reserve in fair value measurement

Movements in value, i.e. gains or losses arising from a change in the fair value of investment property, must be recognised in the profit and loss account for the period in which the change occurs (DAS 270.504).

As, in principle, no frequent market quotations are issued for investment property, the entity recognises a revaluation reserve pursuant to Article 2:390(1) NCC. The revaluation reserve is formed from free reserves or from the profit for the financial year (Article 2:390(1) NCC). The entire revaluation reserve is a non-distributable reserve and must be determined for each investment property individually (Article 2:390(3) NCC).

Pursuant to Article 2:390(3) NCC, the revaluation reserve does not exceed the difference between the carrying amount based on the purchase cost or the construction cost and the carrying amount based on the fair value of the assets to which the revaluation reserve relates that is applied at the time of measurement. The determination of the carrying amount in this context on the basis of the purchase cost or the construction cost:

a. takes into account the accumulated depreciation and impairment losses determined if the cost model had been applied; or
b. disregards any depreciation and impairment losses.

The method used is set out in the notes.

Example: Determining the amount of the revaluation reserve for investment property measured at fair value

Company A acquires an investment property for 1,200 at the start of year 1. After initial recognition at purchase cost, the company measures the investment property at fair value. The property has an expected useful life of 40 years and an expected residual value of nil. At the end of year 12, its fair value is 1,380. The amount of the revaluation reserve can be determined by either of two methods.

Method a: Including accumulated depreciation and impairment losses (recommended in DAS 213.504)

Purchase cost at the start of year 1	1,200
Accumulated depreciation in year 1 to year 12 (= 12 / 40 x 1,200)	360
Carrying amount based on purchase cost including accumulated depreciation and impairment losses	840
Carrying amount on 31 December of year 12 (fair value)	1,380
Revaluation reserve on 31 December of year 12	540

Method b: Excluding accumulated depreciation and impairment losses (stated as an alternative in DAS 213.504)

Purchase cost at the start of year 1	1,200
Carrying amount on 31 December of year 12 (fair value)	1,380
Revaluation reserve on 31 December of year 12	180

If, as a result of DAS 213.504, the method for determining the revaluation reserve differs from the method used in the previous financial year, a change in accounting policies has occurred. Contrary to DAS 140 'Changes in accounting policies', DAS 213.902 allows any change resulting from the application of DAS 213.504 to be recognised prospectively.

The Dutch Accounting Standards Board expressed a preference for method a in the past but now considers both methods equally acceptable. We prefer method b as the revaluation reserve is not based on a physical capital objective (Framework 104b/109) and the legislator's main aim is to lock in unrealised revaluation in equity with a view to capital protection. If the fair value increases, we fail to see why capital protection would be served by a capital lock above the unrealised portion, amounting to the accumulated depreciation applied if measurement at cost had taken place. In the above example, this is the accumulated depreciation in the amount of 360.

Unlike revalued property for own use, investment property recognised at fair value may not be depreciated. However, losses arising from the change in the fair value emerging from the subsequent determination of the fair value are recognised in the profit and loss account. This is actually a logical way to treat investment property, as a reduction in the fair value also represents a loss of economic value. After all, the fair value will largely be based on positive cash flows expected on any valuation date.

Example: Alterations to investment property

A lift is replaced in an office building that classifies as investment property. The investment property is measured at fair value. The fair value of the replaced lift cannot be reliably determined. How will this replacement be recognised?

The costs of the replaced lift are capitalised and the fair value of the building is subsequently determined. Any differences between the carrying amount and the fair value are recognised in the profit and loss account.

8.3.5 The fair value cannot be reliably determined

It is assumed that the fair value of investment property can be reliably determined at any time (DAS 213.512). Only in exceptional circumstances can this assumption be rebutted.

Even if difficulties should arise at any time in obtaining reliable data to determine the fair value, an investment property initially measured at fair value will always have to be measured at that value. It is only possible to depart from the general rule if it is expected at initial recognition that the information needed to arrive at a reliable valuation will not be available in the future. In that case, the investment property is valued at purchase cost, despite the fact that the "current value" accounting principle has been chosen. DAS 212 must then be applied for this investment property, with the investment property being depreciated to a residual value of nil (DAS 213.512). If the fair value of an investment property under development cannot be reliably determined, that property must be measured at cost until the fair value can be reliably determined (DAS 213.512). Of course, any impairment losses must also be taken into account.

This situation is expected to occur very rarely and may only be applied in exceptional cases, e.g. for investment property located in geographical regions where properties are not readily marketable for reasons such as underdevelopment of the region or political or economic instability. Another requirement is that the fair value cannot be reliably approximated, not even on the basis of the present value of the estimated future cash flows (Article 11(1) BAW).

In this situation, all other investment property (whose fair value *can* be reliably determined) remains recognised at fair value in the balance sheet.

8.3.6 Disposal and retirement

An investment property must be derecognised on disposal or when it is withdrawn from use and no more future economic benefits are expected (DAS 213.701). On sale or retirement, the profit or loss is recognised in the profit and loss account. The profit or loss is determined as the difference between the net consideration and the carrying amount (DAS 213.703), also taking into account the costs associated with the sale or retirement. If a sale takes the form of a finance lease (sale and leaseback), the provisions of DAS 292 must be considered in determining the accounting treatment. See also Chapter 22.

8.4 Reclassification

8.4.1 General

With reference to paragraph 8.1, properties can be classified into the following main categories:

- property for own use;
- property under development with a view to sale (inventory); and
- investment property (including investment property under development).

Property for own use is subject to the provisions on tangible fixed assets (see Chapter 7). Property under development with a view to sale is part of inventories (see Chapter 11).

A reclassification to investment property or to property for own use is only permitted in the event of a change in use that is factually substantiated by an actual change in use, as a result of which the property meets, or no longer meets, the definition of investment property (DAS 213.601). A mere change in the board's intention regarding the use of property does not constitute a change in use. Examples of evidence of a change in use are the following (DAS 213.601):

a. actual commencement of own use (or of development for own use), for a reclassification from investment property to property for own use;
b. actual commencement of development with a view to sale, for a reclassification from investment property to inventory;
c. end of own use, for a reclassification from property for own use to investment property; and

d. conclusion of an operating lease contract with another party, for a reclassification from inventory to investment property.

If an entity decides to dispose of an investment property without development, it is classified as investment property until the property is sold and is not reclassified to inventories. Similarly, an existing investment property remains classified as such if an entity begins to redevelop the relevant investment property with the aim of continued future use as investment property. This means that there is no reclassification to property for own use during the period of redevelopment (DAS 213.602).

8.4.2 From investment property to another category

When an investment property measured at fair value is transferred to another category, to either property for own use or inventory, the initial measurement in the new designated use will correspond to the fair value of the property at the time of transfer and there will be no movements in value at that time (DAS 213.604).

8.4.3 From property for own use to investment property

If the own use of a property is discontinued and it is subsequently held as investment property and the entity measures its investment property at fair value, any difference in value between the carrying amount and the fair value apparent at that time must be recognised in accordance with DAS 212 (DAS 213.605). This means that (DAS 213.606):

- any increase in the carrying amount of property as a result of a revaluation is recognised directly in equity (revaluation reserve to be formed pursuant to Article 2:390 NCC). However, the revaluation is recognised in the profit and loss account to the extent that it represents a reversal of an impairment loss of the same property that was previously recognised as an expense in the profit and loss account. The reversal of an impairment loss in the profit and loss account may not result in a carrying amount that exceeds the carrying amount that would have been determined if no impairment loss had been recognised for the property in prior years; and
- any impairment of the carrying amount of property is recognised in the profit and loss account; however, the impairment is charged to the revaluation reserve to the extent of any credit balance existing in the revaluation reserve in respect of the relevant property.

Example: From property for own use to investment property

A property, once acquired for 1,200, has been in own use for eight years. During that time, depreciation was based on an expected useful life of 40 years, taking into account a residual value of 400 (mainly the land). After four years of use, an impairment loss of 180 resulted from a deterioration in the region's economic conditions and business climate. This impairment was charged to the profit and loss account. The carrying amount after this impairment was therefore 940, subject to a depreciation of 15 per year for another 36 years.

After another four years, the use of the property changed and it was reclassified as investment property. Based on valuations at the time (initial measurement as investment property at fair value), the fair value is 1,080. The carrying amount at the time of transfer to the investment property category was 880 (940 after depreciation, less four times a depreciation of 15). As a result, the revaluation at the time of transfer to investment property is 200.

The amount equal to the portion of the impairment still present in the current carrying amount may now be credited to the profit and loss account. Any additional revaluation is added to the revaluation reserve. In this case, the passage of four years means that 20 of the impairment has been "realised" through reduced depreciation and, as a result, 160 is still present in the carrying amount. Here, 160 of the revaluation is credited to the profit and loss account and 40 is added to the revaluation reserve.

8.4.4 From inventory to investment property

On transfer from property classified as inventory to investment property measured at fair value, the difference between the current carrying amount and the fair value is recognised in the profit and loss account (DAS 213.607). This accounting treatment is consistent with the treatment of a sale of a property forming part of the inventory. An upward value adjustment to the higher fair value involves a revaluation for which a revaluation reserve must be formed pursuant to Article 2:390 NCC.

8.5 Presentation and disclosure

8.5.1 Presentation and disclosure - general

Presentation
Investment property is included in a separate item under tangible fixed assets. Technically, investment property comes under "tangible fixed assets not used in operations" (Article 2:366(1)(e) NCC). Property held for sale in the normal business process is regarded as inventories.

A non-investment company with a large number of investment properties cannot use model Q and R (presentation of the balance sheet according to the BMJ, applicable to investment companies) or model S (presentation of the profit and loss account according to point d, applicable to investment companies). Pursuant to DAS 270.512, changes in the value of investment property measured at fair value that are recognised directly in profit or loss must be included by non-investment companies in a separate item in the profit and loss account. The relevant names of the items in model S of the Decree on annual accounts format (unrealised changes in the value of investments) can be used for this purpose.

Investment companies must present the balance sheet in accordance with model Q or R and the profit and loss account in accordance with model S (Article 16b(2) BMJ). Investment companies using model R classify investment property as 'investments', subcategory 'land and buildings' and if model Q is applied as 'investments', subcategory 'land and buildings - other land and buildings'. The changes in fair value are recognised under the item 'unrealised changes in the value of investments', subcategory 'land and buildings', according to the model profit and loss account for investment companies.

Disclosure
Investment property held under operating or finance leases
For investment property held under operating or finance leases, the disclosure requirements stated below supplement those in DAS 292 Leases (see Chapter 22). On this basis, an entity that recognises investment property or a right to use investment property in the balance sheet must provide the same information as a lessor must provide for operating leases (DAS 292.319). If an investment property is held by means of a finance lease, the same information must be provided as a lessee must provide for finance leases (DAS 292.208). In other words, both the disclosure requirements of DAS 213 "Investment property" (see below) and those of DAS 292 "Leases" apply to investment property held under operating or finance leases.

8.5.2 Accounting policy

Measurement at historical cost
The accounting policy of measurement and determination of profit or loss (including depreciation methods) must be disclosed (Article 2:384(5) NCC), as well as the economic life or depreciation percentages applied (DAS 213.805).

Measurement at fair value
The accounting policy is disclosed, supplemented by information on the method for determining the fair value of investment property.

In this context, the disclosure covers the methods and relevant assumptions applied in determining the fair value of investment property and rights to use investment property and the interest rate used (pursuant to Article 11 BAW). This must include a summary showing whether the assumptions are supported by market evidence or are more heavily based on other factors because of the nature of the property and lack of comparable market data. The entity must disclose these factors (DAS 213.802).

The extent to which the fair value of investment property or rights to use investment property is based on a valuation by an independent and expert valuer must be disclosed. If there has been no such valuation, that fact must be disclosed (DAS 213.802).

If, when measuring at fair value, one or a few properties are recognised at historical cost because no reliable fair value (market value) information can be obtained, this fact is disclosed for each property, including the cause and, if possible, an estimate of the range within which the fair value lies (DAS 213.804).

Pursuant to Article 2:368(2) NCC, the sum of revaluations as at the reporting date is disclosed for investment property measured at fair value.

It is also disclosed whether and under what circumstances rights to use property that a lessee classifies as operating leases are recognised as investment property (DAS 213.802).

8.5.3 Movement schedule

Both measurement at historical cost and measurement at fair value are subject to the requirement of including a movement schedule, which must disclose (DAS 213.803 and 805):

- the carrying amount at the beginning of the financial year;
- investments, broken down into initial investments and expenditures after initial recognition;
- investments through business combinations;
- disposal and retirement;
- fair value adjustments, if the current value model is applied, or depreciation, if the historical cost model is applied;
- translation differences of financial statements of foreign entities;
- transfers to and from inventories and property for own use;
- other changes in value; and
- the carrying amount at the end of the financial year.

The Dutch Accounting Standards Board recommends including comparative figures from the previous financial year in the movement schedule if this is important for understanding the relevant item (DAS 110.127).

8.5.4 Other disclosure requirements

In addition, the following components must be disclosed:

- the criteria developed by the entity to distinguish investment property from property for own use and property held for sale in the ordinary course of business (DAS 213.802);
- the numerical disclosure of rental income and operating expenses recognised in the profit and loss account broken down into those relating to leased and to non-leased property (DAS 213.802);
- for properties acquired under finance leases or leased out under operating leases: a summary showing what the future minimum rental income will be, broken down into the periods of up to one year, between one and five years, and more than five years (DAS 292.319);
- in the event of revaluations, whether a deferred tax liability is recognised (Article 2:390(5) NCC);
- for property under development (DAS 213.802b):
  - disclosure of the carrying amount;
  - whether and, if so, to what extent own development costs, other indirect costs and interest have been taken into account in the measurement; and
  - what criteria apply to determine when the development phase for property has ended and it is therefore no longer property under development; and
- significant contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or improvements.

The entity must also disclose the fair value of the investment property; in the exceptional cases described in DAS 213.512 (inability to reliably determine the fair value), the entity must include the following information (DAS 213.805):

1. a description of the investment property;
2. an explanation of why the fair value cannot be reliably determined; and
3. if possible, the range within which the fair value is most likely to lie.

Pursuant to Article 2:366(2) NCC, it is disclosed whether the entity has only a limited right in rem or a personal long-term right to enjoy investment property on a lasting basis. It is also disclosed whether there are restrictions on the use of investment property or the collectability of income (in the event of operation or disposal), as well as the extent of these restrictions.

In respect of the measurement of property under development, it must be disclosed whether and, if so, to what extent own development costs, other indirect costs and interest have been taken into account (DAS 213.805a).

8.6 Exemptions for medium-sized and small entities

Pursuant to Article 2:396 NCC, small entities are exempt from the breakdown into categories of tangible fixed assets (Article 2:366 NCC). Although presenting tangible fixed assets as a single item is permitted, a distinction is made between investment property and property for own use (DASsmall B2.211).

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

8.7 Significant differences from IFRS

Revaluation reserve
For investment property measured at fair value (for which no frequent market quotations are issued), the entity recognises a revaluation reserve pursuant to Article 2:390(1) NCC. IFRS contains no requirement to create a revaluation reserve for investment property measured at fair value.

Assets held for sale
IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" requires that non-current assets, including investment property, the disposal of which is highly probable, be presented in the balance sheet in a separate item under current assets as "held for sale". This presentation takes place from the moment the held-for-sale criteria are met. Investment property measured at historical cost and classified as held for sale, or belonging to a disposal group classified as held for sale, is no longer depreciated from the time it is classified as held for sale, not even if it is still in use. Furthermore, a write-down to fair value less selling costs applies if this is lower than the carrying amount. NL GAAP does not include presentation and measurement requirements for assets and disposal groups held for sale. Unlike IFRS 5, the BMJ does not permit such a method of presentation in the balance sheet.

9 Financial fixed assets

9.1 Introduction

9.1.1 The term participating interest

The term participating interest is important for classification and measurement purposes in the financial statements. The term participating interest is defined in Article 2:24c NCC. There can be a participating interest in an entity (e.g. a private limited liability entity (*besloten vennootschap* ("BV")) or a public limited liability entity (*naamloze vennootschap* ("NV")) and a participating interest in an unincorporated company (e.g. a general partnership (*vennootschap onder firma* ("VOF") or a limited partnership (*commanditaire vennootschap* ("CV")).

A participating interest in an entity
According to Article 2:24c(1) NCC, an entity or a company has a participating interest in an entity if it or one or more of its subsidiaries, solely or jointly, for their own account, contribute(s) or arrange(s) to contribute capital to that entity, to ensure long-term association with that entity to support its/their own activities. This means that participating interests of subsidiaries are also participating interests of the parent entity. If one-fifth or more of the issued capital is provided, it is presumed that a participating interest exists.

Thus, there is a participating interest when two criteria are met, namely:

- capital is contributed for their own account;
- the capital provider has a long-term association with that entity to support its own activities.

The element of providing capital is fundamental. If there is no participating interest in the issued capital of an entity, there is not a participating interest in that entity. In determining whether capital has been provided, share certificates are equated to shares. In addition, capital should be contributed for the capital provider's own account (or for the account of a subsidiary) and not, therefore, at the account of third parties. Long-term association to support the capital provider's own activities distinguishes a participating interest from an investment.

When a shareholding meets the above requirements, it is a participating interest regardless of the size of the equity interest. For efficiency reasons, the law also provides a quantitative criterion for determining whether an equity interest qualifies as a participating interest. It provides that, if an entity, alone or together with its subsidiaries has an equity participation of at least 20% in the issued capital of another entity, there is a legal presumption that this equity participation should be regarded as a participating interest. Both shares without voting rights and shares without profit rights are included in this (Article 2:24d(2) NCC). The fact is that such shares also provide capital. Also, the legal presumption is rebuttable. Thus, an equity participation of more than 20% that demonstrably does not meet the above criteria is not a participating interest. An example might be an equity interest of more than 20% which is held solely as an investment property. In contrast, an equity participation of less than 20% that demonstrably does meet the criteria of a participating interest does qualify as a participating interest (DAS 214.0). Based on the legal definition, participating interests of subsidiaries are also participating interests of the parent entity. The term subsidiary is discussed in paragraph 9.1.2.

Participating interest in an unincorporated company
A participating interest can also be held in an unincorporated company. According to Article 2:24c(2) NCC, an entity has a participating interest in an unincorporated company if the entity or a subsidiary:

- as a partner in that company is fully liable to creditors for its debts; or
- is otherwise a partner in that company in order to have a long-term association with it to support its own activities.

This means that, if an entity is a partner in a general partnership or a managing partner in a limited partnership, it has a participating interest because it is fully liable to the creditors. By contrast, an entity acting as a limited partner in a limited partnership generally does not have a participating interest in that limited partnership, unless it holds that interest in order to have a long-term association with that limited partnership to support its own activities.

9.1.2 The concept of a subsidiary

Art. 2:24a(1) NCC defines the term subsidiary as follows:

- an entity in which the entity itself or one or more of its subsidiaries may, solely or jointly, by agreement with other voting right holders, exercise more than half of the voting rights in the general meeting; or
- an entity of which the entity itself or one or more of its subsidiaries is/are member(s) or shareholder(s) and may, alone or jointly, by agreement with voting right holders, appoint or dismiss more than half of the directors or supervisory directors, even if all voting right holders vote cast their votes.

Subsidiaries also include subsidiaries of an entity's subsidiaries. In other words, the legal term subsidiaries also includes sub-subsidiaries and sub-sub-subsidiaries. For example, if entity A exercises 60% of the voting rights in the shareholders' meeting of entity B and B in turn exercises 60% of the voting rights in the shareholders' meeting of entity C, then C is a subsidiary of both B and A (DAS 214.208). A company acting under its own name in which it or one or more subsidiaries is/are, as a partner, fully liable to creditors for debts is equated to a subsidiary (Article 24a(2) NCC). In short, if an entity acts as a partner in a general partnership or as a managing partner in a limited partnership, that general partnership or limited partnership are considered subsidiaries of that entity.

9.1.3 The term joint venture

A joint venture exists where activities, whether or not conducted in the form of an entity or a company, are subject to joint control as a result of a partnership agreement between a limited number of participants (DAS 215.0). In determining whether a partnership qualifies as a joint venture, relative control is decisive, not the relative ownership interest (DAS 215.202). See Chapter 34 for further details.

9.1.4 Other securities

Equity interests that do not qualify as participating interests are classified under securities (DAS 214.203). See paragraph 2.11 regarding the classification of securities as fixed or current assets. See paragraphs 9.2.8 and 9.3.5 regarding the recognition, measurement and disclosure of securities classified as fixed assets. The recognition, measurement and disclosure of securities classified as current assets is described in Chapter 13.

Equity interests held by investment entities, regardless of their size, are usually classified as 'other securities' (financial fixed assets). Given the fact that these interests relate to the main activity of the investment entity, a custom name is generally used to refer to them. These equity interests do not constitute participating interests, as they are not held on a long-term basis to support the company's own activities (DAS 214.204). If an investment entity avails itself of the consolidation exemption provided by Article 2:407(1)(c) NCC (see paragraph 33.4.3), it must therefore also classify its controlling interests as securities and account for them as such (DAS 217.308a).

9.2 Measurement and determination of profit or loss

9.2.1 The acquisition cost of a participating interest

The acquisition cost should be set at the monetary amount or equivalent agreed for the participating interest, or the fair value (at the time of acquisition) of the other consideration provided by the participating entity in exchange for the equity interest in that participating interest plus any costs directly attributable to that acquisition (DAS 214.305).

Directly attributable costs may include the costs of registration and issue of shares as well as the costs of accountants, lawyers, valuers and other advisers for making the acquisition of the participating interest. The acquisition cost does not include general administrative costs (including the costs incurred by a department charged with administering the acquisition) or other costs not specifically attributable to the acquisition (DAS 216.207).

See Chapter 31 for a more detailed explanation on determining the acquisition cost of a participating interest.

9.2.2 Accounting principles and the criterion of significant influence

The measurement of participating interests depends on the degree of influence that can be exercised.

Participating interests in companies in which the participating entity exercises significant influence on business and financial policy are accounted for using the net asset value method (Article 2:389(1) NCC). Participating interests in companies in which the participating entity does not exercise significant influence on business and financial policy are measured at acquisition cost or current value (Article 2:384(1) NCC). The actual situation is decisive when determining whether there is a participating interest in which significant influence is exercised. For example, certain financial instruments that carry potential voting rights may be held by the participating entity or by third parties. Financial instruments that carry potential voting rights and can be exercised in such a way that they give the participating entity more or less influence in another entity should also be taken into account when determining whether it has a participating interest in which it exercises significant influence on business and financial policy.

Example: potential voting rights

A owns 40% of C's ordinary share capital (and the voting rights attached to it). A sells 30% of its shares in C to D, which until then had not owned any shares in C. A also acquires a call option from D to repurchase these (30%) shares in C. This call option is immediately exercisable at a price slightly higher than the market price of those shares when the option was issued. The exercise price of the option is not set so high that it is highly unlikely that the option will be exercised. The fact that A acquired the call option means that it can still exercise significant influence in C (barring any other circumstances or contractual relationships that might mean this is not the case), despite its directly held interest having fallen to 10%. The fact is that A can exercise the option at any time and thus again exercise 40% of the voting rights in C.

All the facts and circumstances are taken into account when assessing whether financial instruments carrying potential voting rights confer greater or lesser influence. These facts and circumstances include, but are not limited to, the following (DAS 214.303):

- (economic or other) impediments preventing the holder(s) of the potential voting rights from exercising them;
- the ability of the rights owner(s) to benefit from exercising their rights.

If, in the above example, the exercise of potential voting rights is unlikely because, for example, A does not have or is unable to obtain sufficient financial resources to exercise, or because exercise is unlikely due to the exercise price, the call option will not be taken into account when determining whether significant influence is present.

There is a presumption of significant influence when an entity can exercise a fifth or more of the voting rights of the members, partners or shareholders at its discretion, either separately or jointly with its subsidiaries (Article 2:389(1) NCC). Where the participating entity holds less than 20% of the voting rights, it is not presumed to exercise a significant influence unless it can clearly demonstrate that it does. The existence of significant influence may be demonstrated by one or more of the following circumstances (DAS 214.302):

- representation by the participating entity on the board of the participating interest or on a similar authoritative body;
- involvement of the participating entity in determining the policy of the participating interest;
- material transactions between the participating entity and the participating interest;
- mutual exchange of managers between the participating entity and the participating interest;
- the provision of essential technical information.

9.2.3 Measurement according to the net asset value method

A participating interest in which the participating entity exercises significant influence is measured using the net asset value method (Article 2:389(1) NCC / DAS 214.301). The characteristic feature of the net asset value method is that it is not the dividend received or declared by the participating interest, but rather the participating entity's share in the participating interest's profit or loss that is recognised in the profit and loss account. The reason for applying the net asset value method is that the recognition of dividend distributions from the participating interest as income provides little information on the actual profits and losses of that participating interest. If a participating entity exercises significant influence, it is in a position to influence the return from the participating interest. Recognition of the share in the profit or loss from the participating interest then provides better insight into the return from the investment in that interest.

According to this method, the participating interest at reporting date is in principle measured as follows:

Carrying amount at the start of the financial year	a
Plus: share in the profit (or loss) from the participating interest	b
Less: dividend declared	c
Plus/less: direct changes in equity (e.g. revaluations)	d
Carrying amount at year-end	a + b - c +/- d

When applying the net asset value method, the profit or loss recognised is the change in the carrying amount of the participating interest since the previous financial statements due to the profit or loss achieved by that interest, to the extent that it is attributed to the participating entity. Article 2:389 NCC provides two different versions of the net asset value method. These are discussed below:

- net asset value (para. 2); and
- visible equity (para. 3).

9.2.4 Valuation at net asset value

Participating interests in which the participating entity exercises significant influence over business and financial policy are measured at net asset value (Article 2:389(1) NCC). According to Article 2:389(2) NCC, a participating entity determines the net asset value of its participating interest by measuring the assets, provisions and debt of the participating interest and calculating its profit or loss using the same principles it applies to its own assets, provisions and debt.

Commencement
Measurement at net asset value should generally start on the date on which a participating interest is acquired. The acquisition date is the date when the participating entity acquires significant influence over the participating interest's business and financial policy. This date may differ from the date when the purchase agreement was concluded or the date when the participating interest is contractually deemed to have been held (with or without retroactive effect) for the acquirer's own account. The acquisition of significant influence over business and financial policy often coincides with the participating entity actually starting to hold the participating interest for its own account, as may be evidenced, for example, by agreements on the transaction price.

Determination of net asset value
At the time of purchase, a participating entity determines the net asset value of the participating interest by calculating its share of the fair values of the individual assets and liabilities of that interest. These values need not necessarily be the same as the values that the participating interest recognises on its balance sheet. Where it is impracticable to make certain adjustments pursuant to the participating entity's accounting principles, this is disclosed in the notes (DAS 214.307).

Example: determination of net asset value

At the end of the financial year, entity A bought 75% of entity X's shares for 800. ABC prepares its financial statements on a historical cost basis. X's balance sheet is as follows:

	D	C
Tangible fixed assets	500	
Inventory	400	
Receivables	100	
Issued capital		100
Other reserves		300
Debt		600
	1,000	1,000

The tangible fixed assets include a unrecognised reserve of 500. The deferred corporate income tax rate is 20%. The remaining useful life of the tangible fixed assets is 20 years.

The net asset value of X is:

Equity		400
Plus: unrecognised reserve of tangible fixed assets	500	
Less: deferred corporate income tax	(100)	
		400
Net asset value		800

A therefore measures its participating interest in X at 600 (= 75% of 800). The positive difference between the acquisition cost of a participating interest and its initial measurement based on net asset value is goodwill:

Acquisition cost	800
Share in net asset value	600
Goodwill	200

Positive goodwill
Positive goodwill is the positive difference between the acquisition cost of a participating interest and its initial measurement using the net asset value method. In the example above, this is therefore 200. On the basis of Article 2:389(7) NCC, positive goodwill is not included as part of the measurement of the participating interest, but is recognised and presented separately under intangible fixed assets.

A special situation arises if the value based on the net asset value method is negative. In that case, the amount of goodwill depends on whether the participating entity guarantees the debt of the participating interest, wholly or in part, or whether it has a constructive obligation to enable the participating interest to pay its debt (DAS 214.333a). See paragraph 6.2.1 for more details on this.

Negative goodwill
Negative goodwill is the negative difference between the acquisition cost of a participating interest and its initial measurement using the net asset value method. Unlike positive goodwill, Article 2:389(7) NCC does not contain any provisions about the recognition and presentation of negative goodwill. The Dutch Accounting Standards Board refers to the provisions on negative goodwill in mergers and acquisitions in DAS 214.336 (see paragraph 6.3).

In the case of participating interests in which merely significant influence is exercised and which are therefore not consolidated, negative goodwill rarely occurs. A key reason for this is that negative goodwill often arises from including and measuring identifiable intangible assets at fair value in a participating interest's net asset value. However, even in this situation, the provisions for the recognition and initial measurement of an intangible fixed asset acquired as a result of an acquisition apply. In this situation, those provisions often result in no intangible assets (or fewer of them) being included in the measurement of the participating interest because:

- intangible assets should not be recognised as part of net asset value if their fair value cannot be determined reliably (DAS 210.211b). This will often be the case if the participating entity does not have control of the participating interest (but rather only significant influence); and
- recognising an intangible fixed asset should not result in negative goodwill unless there is an active market for that asset (DAS 210.212).

Goodwill solely upon acquisition of an integrated business
When an entity acquires participating interests measured at net asset value, goodwill may only be recognised if that entity acquires an integrated set of activities, assets and/or liabilities capable of generating revenue. This is consistent with the scope of mergers and acquisitions (DAS 216); see Chapter 31. See Chapter 6 regarding the recognition of goodwill.

Example: qualification of integrated set of activities when acquiring a participating interest

Entity A, a private limited liability entity, acquires 30% in the share capital with voting rights of B, also a private limited liability entity, for 1,500. B's only asset is an investment property.

The acquisition of this participating interest does not include an integrated set of activities, assets and/or liabilities. A merely participates in an entity that has just one asset. Therefore, no goodwill may be recognised in the initial measurement of this participating interest. The entire acquisition cost of the participating interest should be allocated to the investment property. This means that, at the time of acquisition, the participating interest is recognised at a net asset value of 1,500 on A's balance sheet.

Application of net asset value after the acquisition of a participating interest
If a participating entity prepares its financial statements on a historical cost basis, the assets and liabilities of the participating interest are also measured on this basis (in order to determine the net asset value). For the participating entity, the fair value of the individual assets and liabilities of its newly acquired participating interest at the date of acquisition is the historical cost of those assets and liabilities. When a participating entity applies the net asset value method, even though the participating interest does not apply that entity's accounting principles, the profit or loss recognised by the participating interest must be adjusted to the participating entity's accounting principles before its share in the participating interest's profit or loss can be determined (DAS 214.314).

Example: Application of the net asset value

In the above example regarding the determination of net asset value, participating entity A will adjust the profit or loss generated by the participating interest in the year after the acquisition. The fact is that the participating interest will depreciate its tangible fixed assets based on the carrying amount at the historical cost according to its own balance sheet of, say, 500 (from the perspective of the participating interest itself). In order to determine the participating interest's profit or loss, the participating entity will determine the depreciation of these tangible fixed assets on the basis of its own acquisition cost of 1,500 (= fair value of the tangible fixed assets at the acquisition date).

If the participating entity measures at current value, it also determines the net asset value based on the fair value of the individual assets and liabilities of the participating interest at the time of the acquisition. It will be clear that, at the time the participating interest is acquired, the cost and fair value of the participating interest's assets and liabilities are equal.

Adjustment of carrying amounts in the participating interest's financial statements
The acquired entity is not permitted to adjust the carrying amounts of its assets and liabilities in its own financial statements to reflect the (initial) measurement of identifiable assets and liabilities used by the acquiring entity based on the provisions of DAS 216.208 to 235 and DAS 216.244 to 248 (also referred to as "push down accounting"). The acquired entity is, however, permitted to change its accounting policies if it acts in accordance with DAS 140 (DAS 216.249). For example, the acquired entity may adjust its accounting policy it uses to measure its tangible fixed assets to the accounting policy used by the acquiring entity to measure such assets. Examples of adjustments that the acquired entity may not make include capitalising the goodwill paid by the acquiring entity itself or adjusting the measurement of existing debt to the market value of that debt (by entering any premium or discount). See also the example in paragraph 31.3.4.

9.2.5 Measurement based on visible equity

Reason for applying this method
The basic principle of Art 2:389 NCC is that participating interests in which the participating entity exercises significant influence over business and financial policy are measured at net asset value. However, there may sometimes be circumstances that prevent measurement at net asset value because the entity has insufficient data available to determine or estimate the net asset value (Article 2:389(3) NCC). This could occur if the participating entity cannot actually exercise decisive control, even though it exercises significant influence. It may then not be able to obtain sufficient data, nor be able to oblige the participating interest to apply the participating entity's accounting policies. In that case, the principle of measurement based on the visible equity of the participating interest is applied (DAS 214.310, 311 and 324).

System of recognition
In the event of measurement based on the participating interest's visible equity, the equity according to the participating interest's balance sheet is taken, upon initial application, as the starting point for measurement in the participating entity's balance sheet. The difference between the purchase price and the share in the participating

interest's visible equity is classified as goodwill. Changes in the carrying amount after the initial application are made in accordance with the accounting principles of the participating interest (DAS 214.311). The participating entity includes its share in the profit or loss from the participating interest in its profit and loss account. Dividends received from the participating interest are deducted from the carrying amount of the participating interest (Article 2:389(3) NCC).

9.2.6 Measurement according to the net asset value method: other aspects

Special kinds of shares

When measuring according the net asset value method, the special nature of shares or share certificates has to be taken into account (DAS 214.326). These include priority shares, preference shares or shares that do not share in the profit or the reserves, or only do so to a limited extent. For such shares, measurement under the net asset value method is only applicable to the extent that they carry the same profit and proprietary rights as ordinary shares (DAS 214.326 and 317a). In other cases, the special nature of shares or share certificates is taken into account when measuring them, e.g. where no rights to reserves are embodied in these shares. This means that they are mostly measured at acquisition cost (DAS 214.326). Shares not entitled to profit or reserves are not, therefore, included in the net asset value method measurement. Shares in private limited liability entities that are non-voting under the articles of association have the same rights to profit and reserves as ordinary shares. These are therefore fully included in the net asset value method measurement (DAS 214.326a), just like ordinary shares. If only non-voting shares are held, no significant influence can be exercised over financial and business policy and the net asset value method does not come into play. In that case, other securities are involved (see paragraph 9.1.4).

Example: Application of the net asset value method for special kinds of shares

Company X has 1,000 issued shares, each with a nominal value of 100. The net asset value of X at 31 December is 1,000,000 (excluding nominal value, i.e. 900,000) and the profit for the financial year is 100,000. The following has been issued:

a. 400 non-voting shares. These shares do share fully in the profits and reserves;
b. 400 ordinary shares. These shares have both voting rights and entitlement to a proportionate share of the profits and reserves;
c. 100 shares with limited profit rights. These shares have voting rights but are only entitled to 50% of the profits and reserves;
d. 100 non-participating shares. These shares have voting rights but do not share in the profits or the reserves.

This means that there are 600 shares with voting rights (= 400 + 100 + 100) and the right to profit and reserves is apportioned among 850 "units" (= 400 + 400 + 100 / 2).

Holding entity X holds 100 non-voting shares, 200 ordinary shares, 50 shares with limited profit rights and all (100) non-participating shares. The total is therefore 450 shares, which therefore have a nominal value of 45,000. This package confers majority voting rights on holding entity X, namely 58% (rounded off) (= (200 + 50 + 100) / 600). As holding entity X has the majority of voting rights, it also exercises significant influence over X's policies and therefore measures its participating interest in X at net asset value in the company-only financial statements. What matters for this measurement is the portion of the profits and reserves that accrues to X. This is 38% (rounded off) (= (100 + 200 + 50 / 2) / 850). The measurement at 31 December is then 387,000 (= 38% of 900,000 + 45,000 nominal). Its share of profit for the financial year is 38,000 (= 38% of 100,000).

Example: Application of the net asset value method for preference shares

Participating interest D has an issued capital of 100,000, divided into 500 ordinary shares and 500 preference shares with a nominal value of 100. No share premium has been paid. The preference shares are entitled to a cumulative preference dividend of 8% and do not share in the reserves. D's net asset value is 550,000. Entity A holds 250 ordinary shares and all the preference shares, thus providing 75% of the capital of participating interest D. A acquired the shares it holds at their nominal value. The remaining ordinary shares are held by third parties. Because A exercises significant influence over D's business and financial policies, it measures participating interest D at net asset value in the company-only financial statements.

A measures its interest in participating interest D at 300,000 in the company-only financial statements. This consists of the preference shares, at the acquisition cost of 50,000, and the ordinary shares, at the net asset value excluding preference shares of 250,000 (50% of 550,000 less 50,000).

It also has to be borne in mind that preference shares that the issuing entity classifies as loan capital (see paragraph 21.8) will be classified as receivables by the participating entity. Indeed, in such cases, the economic reality is that it is not an equity instrument of the issuing entity but rather a financial liability of that entity. The mirror image of this economic reality is then that the preference shares in question are classified as a receivable for the party holding them. According to the "substance over form" principle (see paragraph 2.4.3), these preference shares should be presented as a receivable in line with economic reality.

Example: classification of preference shares by the holder

A Group is a private limited liability entity that holds group entities of companies belonging to family A. Until recently, all shares were held by father A, through his personal holding entity PH A, also a private limited liability entity. A restructuring took place as part of a business transfer to his two sons. In that restructuring, the sons incorporated a new holding entity, namely A Group Holding (also a private limited liability entity), all the shares of which are held by the two sons' personal companies. After it was incorporated, PH A contributed all the shares in A Group BV to A Group Holding against the issue of cumulative preference shares. A Group Holding undertook in that regard to repurchase those preference shares in the years to come for a pre-agreed price and according to a certain schedule. Based on these provisions, the preference shares for A Group Holding are classified as liabilities in the consolidated financial statements. For PH A, the preference shares are classified as a receivable. PH A recognises the contribution transaction as the sale of its participating interest A Group, with the purchase price remaining payable.

Impairment of participating interest

Determining whether there is impairment is subject to DAS 121 (see also Chapter 10). If a participating interest incurs continuing losses, this constitutes a significant indication of impairment (DAS 214.330). If a participating interest is measured using the net asset value method, that already, in principle, takes impairments into account. The fact is that the participating interest itself already takes impairment into account when measuring its assets. When applying the net asset value method, these impairments are reflected in the value of the participating interest on the participating entity's balance sheet. However, there may be situations where the participating interest has not recognised an impairment or cannot recognise an impairment itself. One possible example of the first situation is where a participating interest prepares its financial statements earlier than the participating entity does so. In the intervening period, information could become known that necessitates impairment of the participating interest (for example, when a claim becomes known). One possible example of the second situation is where a participating interest intends to dispose of a participating interest and the expected sale value is lower than the carrying amount under the net asset value method (DAS 214.331). When either of these situations occurs, there is an impairment that has to be reflected in the participating entity's financial statements. This means that a write-down of the value of the participating interest must be charged to the profit and loss account (Article 2:387(4) NCC). This write-down will be recognised as profit or loss from participating interest.

Participating interests with negative equity

When a participating interest is measured at nil according to the net asset value method, this method should no longer be applied and, if its circumstances do not change, that participating interest continues to be measured at nil. When measuring a stake in a participating interest with negative equity, the other long-term stakes in that participating interest that in fact have to be considered part of the net investment should also be taken into account

(DAS 214.340). Thus, an item whose settlement is not planned in the near future and is unlikely to be settled in the near future is essentially an increase in the investment in the participating interest. Such items may include long-term interests provided by the participating entity to the participating interest through another group entity (see example 1).

Trade receivables and trade payables are not part of a net investment. To the extent that receivables remain outstanding against the participating interest after the aforementioned items have been written down, further impairment should be assessed on the basis of DAS 290 "Financial Instruments" (see paragraph 21.6.4.5).

If the participating entity guarantees the debts of the participating interest, wholly or in part, or it has a constructive obligation to enable (for its share) the participating interest to pay its debts, the participating entity must make a provision if and to the extent that the recognition criteria for provisions are met (DAS 214.339). This means that a provision is recognised if there is a probable outflow of resources and a reliable estimate can be made of the amount of the provision (DAS 252.424/201). If the best estimate is that there is no outflow of resources from the participating entity because the participating interest can meet its obligations independently, then the participating entity does not recognise a provision. Therefore, it is certainly not a given that in a situation of general or specific guarantees, a provision equal to the negative value of the participating interest must be recognised. The participating entity makes a provision for the expected outflow of resources, and this expected outflow may be less than the negative equity of the participating interest, for example, in the case of significant unrecognised reserves in the assets of the participating interest. The principle of best estimate must be respected as is the case with every provision (see example 2 below). The provision is recognised on the credit side of the balance sheet.

For participating interests with negative equity, differences arise between equity and profit or loss according to the company-only and consolidated financial statements if the provision for participation in the participating entity is not equal to the negative equity of the participating interest (DAS 214.333a / DAS 252.425). The participating entity should then only once again recognise any subsequent share in the profit of the participating interest if and to the extent that its cumulative, unrecognised share in the loss has been made up (DAS 214.339). The notes should disclose the unrecognised share in any loss incurred by participating interests, both cumulatively and as regards the share relating to the reporting period (DAS 214.620).

Example: participating interest with negative equity (1)

A BV, a private limited liability entity, owns 100% of the shares in B BV and 100% of the shares in C BV, both of them also private limited liability entities. A measures its participating interests at net asset value. B has negative equity. C has a positive net asset value. C has granted a loan to B to finance B's (loss-making) activities. This loan is not planned to be settled in the near future, nor is that likely to happen.

This means that, when measuring its participating interest B at net asset value, A has to consider C's receivable from B, in accordance with DAS 214.340. In A's company-only balance sheet, that receivable is included in the net asset value of participating interest C. This means that the measurement of participating interest C should be reduced by the negative net asset value of participating interest B. If a negative amount remains after this write-down, a provision may have to be created (see example 2 below).

Example: participating interest with negative equity (2)

Entity A has assumed liability under Article 2:403(1) NCC for debts arising from legal acts of its 100% participating interests B and C. A measures its participating interests at net asset value. B has negative equity of 500. A has loaned 300 to B. C's net asset value is 500.

A should measure its participating interest in B at nil. A will then have to assess the measurement of its receivable from participating interest B to determine whether a write-down is necessary. It is uncertain whether A can recover its receivable, particularly in view of B's loss-making situation. Given that A has assumed liability for B's debts arising from legal acts, A has to recognise a provision under liabilities in the amount of the losses it expects from that liability. If there is a legitimate expectation that B can settle its debt itself, no provision needs to be recognised.

In determining the size of this provision, any already recognised impairment of the receivable from B should be taken into account. In practice, B's negative net asset value is usually deducted, to the extent possible, from entity A's receivable from B.

If A's receivable from B should in fact be considered part of its net investment in B, the measurement of its interest in B should include this receivable. This means that A's receivable from B is written down to nil. The negative amount of 200 remains after this write-down. The size of the liability provision should then be determined in accordance with DAS 252 regarding provisions.

If A's receivable from B is not considered part of its net investment, the recoverability of A's receivable from B should be assessed on its own merits, as is the case for other receivables. If its receivable from B is not written down, entity A will recognise a higher provision under liabilities than if it *were* to have written down its receivable from B (*ceteris paribus*).

In determining the size of this provision, there could be reason to take account of the net selling price of participating interest B's assets (e.g. unrecognised reserves on buildings). This is because the net selling price of assets may differ, negatively or positively, from the carrying amounts on which the negative net asset value is based. On the other hand, consideration must also be given for contingent liabilities for which no liability is recognised on the balance sheet.

Therefore, the provision that A makes for participating interest B will often not be equal to the amount of the negative equity of the participating interest. As explained above, the provision must meet the recognition criteria of provisions (DAS 252.201).

Finally, note that netting of positive and negative values of participating interests is not allowed. Accordingly, B's negative net asset value may not be netted against C's positive net asset value.

Example: acquisition of a participating interest with negative equity

If a participating interest is acquired whose net asset value based on the fair values of identified assets and liabilities is negative upon initial recognition, it is relevant whether the acquiring entity has assumed liability for the acquired entity's debt. Let us assume that the participating interest was acquired for no consideration. If the acquiring entity is not liable for the acquired entity's debt, its participating interest is recognised at nil on the balance sheet and no liability is recognised. If the acquiring entity is, however, liable for this debt, its participating interest will be measured at nil and a provision will be simultaneously recognised for that liability. The difference between nil and the amount recognised in the liability provision is then recognised as goodwill (DAS 214.333a).

Dilution gains and losses

Dilution occurs when a participating interest issues shares to third parties that cause the participating entity's relative interest in the participating interest's equity to exceed or fall below that participating interest's net asset value previously recognised by the participating entity (DAS 214.315).

Example: dilution gain

Entity A has a 100% interest in entity B. B's year-end net asset value is 1,000. At the end of the financial year, B issues shares to Z. Z acquires a 50% interest in B and pays 1,500 for it. This increases B's equity to 2,500. A's interest has thus fallen to 50%, but its value has increased to 1,250. A has therefore realised a dilution gain of 250.

A dilution gains and losses can be recognised in either of two ways:

- in the profit and loss account; or
- directly in equity.

A dilution gain or loss is recognised in the profit and loss account if the participating entity takes the view that the economic reality of that recognition corresponds to the sale of some of the shares. Viewed this way, the dilution gain or loss corresponds in terms of its economic reality to a gain or loss on the sale of some of the shares. On the other hand, if the participating entity views the dilution as an equity transfer between existing and new shareholders, recognising the dilution gain or loss in equity is the obvious choice. The Dutch Accounting Standards Board does not express a preference for either recognition method. The nature and extent of dilution gains and losses and the method of their recognition have to be disclosed separately (DAS 214.315).

Example: Dilution gain (continued)

The entry is as follows if the view is taken that there has been an equity transfer between shareholders:

Participating interest	250	
Other reserves		250

If this is considered to be the sale of an interest, the entry is as follows:

Participating interest	250	
Dilution gain participating interest		250

If Z had only paid 800 for its 50% participating interest, B's equity would have increased to 1,800. A's interest in B would then have fallen from 1,000 to 900. This would then mean a dilution loss of 100 (= 1,000 - 900) for A.

Reverse dilution

If a participating interest repurchases its own shares from shareholders other than the participating entity, thereby increasing the participating entity's relative interest in that participating interest (so-called reverse dilution), any difference at the participating entity between the cost of the participating interest's repurchasing of its own shares and the relevant *pro rata* portion of the net asset value should be recognised either as an initial measurement of the participating interest in accordance with DAS 216 or directly in equity (DAS 214.318). As with dilution gains and losses, the choice depends on the view taken by the participating entity. The above difference can be considered as (1) the result of an (indirect) purchase (i.e. increase) of a stake in the participating interest or (2) as an equity transfer between the participating interest's shareholders. In the first view, the relevant difference is accounted for as either positive or negative goodwill. In the second view, the difference is recognised directly in equity.

Example: reverse dilution

Elaborating on the example about the treatment of dilution gains, A and Z each have a 50% interest in B. As stated, B's equity increases to 2,500 after Z's share purchase. A therefore recognises a participating interest of 1,250 on its balance sheet; Z does the same. B then repurchases half of Z's shares (which is effectively a repurchase of 25% of its issued shares) for 1,000.

B's equity falls to 1,500 (= 2,500 - 1,000) as a result. A then has 66 2/3% of the then issued shares (the fact is that A then has twice as many shares as Z). A's share in B's equity is then 1,000 (= 66 2/3% of 1,500). A has thus incurred a loss of 250 (= 1,250 - 1,000) due to reverse dilution. This 250 is equal to the excess Z received for the 25% share repurchase compared to its relative share of this 25% in B's equity (= 1,000 - (25% of 2,500) = 375), to the extent that this is still attributable to A's interest in B after the share repurchase (= 66 2/3% of 375 = 250). So Z paid for this 125 (= 375 - 250) itself. As regards the 250, equity has in fact moved from A to Z.

Entry at A, assuming the view that this was an equity transfer between shareholders:

Other reserves	250	
Participating interest		250

Entry at A, assuming the view that it was the purchase of an interest:

Goodwill	250	
Participating interest		250

The view taken is also important for Z's recognition of this transaction. Z retains a participating interest of 500 (= 33 1/3% of 1,500).

Entry at Z, assuming the view that this was an equity transfer between shareholders:

Bank	1,000	
Participating interest (= 1,250 - 500)		750
Other reserves		250

Entry at Z, assuming the view that this was the sale of an interest:

Bank	1,000	
Participating interest (= 1,250 - 500)		750
Profit from sale of a participating interest		250

In the event of reverse dilution, it is also possible that the participating entity acquires control over a participating interest. This is the case if the participating interest buys back its own shares from other shareholders, thereby increasing the relative interest of the participating entity to such an extent that it acquires control. In this situation, there is a step acquisition. See also chapter 31.3.6.

Loss of significant influence over business and financial policies
In practice, the situation may arise where, after the acquisition of a participating interest, the participating entity loses the significant influence over its participating interest's business and financial policy that it used to have. In this situation, the last known net asset value should be taken as the basis for further measurement of the participating interest at acquisition cost or current value (DAS 214.321). The last known net asset value should be increased by the goodwill still capitalised at the time of the loss of significant influence as regards any remaining interest in that participating interest. The value thus determined is the starting point for measurement at acquisition cost or current value. If the goodwill relating to any remaining interest has in the past been charged directly to equity or credited immediately to the profit and loss account, that goodwill is not included (DAS 214.321).

Example: Loss of significant influence

Entity A bought 30% of entity B's shares for 800 on 1 January of year 1. On 31 December of year 5, 15% of the shares are sold for 600. Let us assume that, as a result, A is no longer able to exercise significant influence over B's policies. The net asset value of the 30% interest in B in A's financial statements is 900 as at 31 December of year 5 (before the sale of the 15% interest) and goodwill in the amount of 120 is still capitalised for this interest.

Due to the loss of significant influence over policy, A measures its interest in B at cost from 31 December of year 5. This cost is determined at 510 (= net asset value of 450 plus the goodwill still capitalised in respect of the remaining interest of 60). The profit on the sale of this 15% interest is therefore the sale price of 600 less 510.

The entry made for the sale of this 15% interest is as follows:		
Bank (or receivable from buyer)	600	
Profit on sale of 15% interest		90
Participating interest (measured at net asset value)		450
Goodwill		60
The loss of significant influence is recognised as follows:		
Participating interest (measured at cost)	510	
Goodwill		60
Participating interest (measured at net asset value)		450

As a result of an agreement, the dilution of equity interest and a loss of significant influence may occur simultaneously. If this is the case, the dilution gains or losses are recognised first, followed by the effect of the loss of significant influence (DAS 214.322).

Legal reserve for participating interests
According to Article 2:389(6) NCC, an entity must maintain a legal reserve when measuring participating interests using the net asset value method. This is determined as follows:

Share in profits from participating interests since initial measurement	000
Direct equity increases in the participating interest since the initial measurement	000
Direct equity decreases in the participating interest since the initial measurement	(000)
Distributions to which the entity was entitled from the initial measurement up to the adoption of the financial statements	(000)
Distributions that the entity can effect without limitation	(000)
Legal reserve for participating interests	000

At the time of the first measurement of the participating interest under the net asset value method, this legal reserve is therefore zero. Direct equity increases arising from the entity's financial relationship with its participating interest as a shareholder (e.g. an additional share premium payment) are not covered by the legal reserve (DAS 240.229a).

The legal reserve is reduced by the distributions to which the entity has been entitled from the initial measurement until the adoption of the financial statements as well as by distributions that it can effect without limitation. Such limitations may result from circumstances such as a lack of control, obstacles in foreign payment transactions, legal reserves to be maintained at the participating interest, or if the participating interest is restricted in making distributions because continuity can otherwise no longer be guaranteed.

When determining the amount of the legal reserve for participating interests, those participating interests whose cumulative profits and losses since the initial measurement has not been positive are disregarded (Article 2:389(6) NCC). The legal reserve is not, therefore, determined for the entirety of the entity's participating interests, but rather for each individual participating interest.

Paragraph 14.3.8 discusses the legal reserve for participating interests in more detail.

Revaluation of assets in participating interests measured at net asset value
When revaluing assets in participating interests that have been measured at net asset value, the question is how the participating entity should recognise this. According to a guideline issued by the Dutch Accounting Standards Board, both a revaluation reserve (to which the provisions of Article 2:390 NCC apply) and a reserve for participating interests (to which the provisions of Art. 2:389(6) NCC apply) may be created (DAS 240.228).

The latter option is based on a literal interpretation of the current text of Article 2:389(6) NCC. On this basis, it can be argued that direct equity increases in the participating interest may also include revaluations of that participating interest.

Example: Revaluation of assets in a participating interest

Company A has a 100% interest in company B. A uses current value as the measurement principle for the buildings. At B there is a building whose current value increases by 100. B also measures the buildings at current value. B recognises the revaluation as follows (using a tax rate of 30%):

Buildings	100	
Deferred tax (= 30% of 100)		30
Revaluation reserve		70

A recognises the revaluation of the buildings at B in its company-only financial statements as follows:

Participating interest B	70	
Revaluation reserve *or* In Reserve for participating interests		70

A recognises the revaluation of the buildings at B in its consolidated financial statements as follows:

Buildings	100	
Deferred tax (= 30% of 100)		30
Group equity (the entity's share)		70

Application of Article 2:389(9) NCC

According to Article 2:389(9) NCC, Article 2:389(1) NCC (measurement at net asset value according to the net asset value method) need not be applied where there are valid reasons for this, which reasons must be disclosed in the notes. DAS 214.325, in accordance with the legislative history, lists as possible valid reasons the international entanglement or the application of Article 2:408 NCC (exemption from consolidation for intermediate holding entities), on the basis of which it is justified not to apply Article 2:389(1) NCC in the company-only financial statements, apart from the insight provided by the parent entity's consolidated financial statements. The condition provided by Article 2:408 NCC is that the financial data that an entity would have to consolidate have been included in the consolidated financial statements of a larger entity. In the situation described by Article 2:408 NCC, it is clear that these are the consolidated financial statements of the parent entity, which is therefore separate from the entity that does not wish to apply Article 2:389(1) NCC.

Example: Application of Article 2:389(9) NCC

Entity A is a subsidiary of a US parent entity. A does not carry out independent activities and but only holds domestic and foreign participating interests. As an intermediate holding entity, A exercises the exemption from the consolidation obligation (Article 2:408 NCC), meaning that it is sufficient for it to prepare company-only financial statements. According to Article 2:389(9) NCC, entity A may then measure its participating interests (i.e. both the participating interests to be consolidated and those in which significant influence can be exercised) in the company-only financial statements in accordance with Article 2:384(1) NCC. Article 2:384(1) NCC lists purchase cost and current value as accounting principles. However, the Decree on current value (*Besluit actuele waarde*) does not allow participating interests in which significant influence is exercised (within the meaning of Article 2:389(1) NCC) to be measured at current value (Article 10(3)(c) of the said Decree). This means that A may only measure its participating interests at acquisition cost when applying Article 2:389(9) NCC.

The legislative history does not elaborate on international entanglement. This could be the case if an intermediate holding entity with a foreign parent company does not wish to or cannot exercise the consolidation exemption (Article 2:408 NCC), but wants to deviate from Article 2:389(1) NCC in its own company-only financial statements. This is because it is the parent company's policy (including in its own financial statements) to measure participating interests at cost in its company-only financial statements. Given that, in this case, the participating interests in question are consolidated in the consolidated financial statements of the intermediate holding entity, there is an insight into the asset values of the participating interests at that level.

It also happens that foreign parties place extensive foreign activities under a Dutch holding entity. This entanglement is then reflected in the branching under the Dutch holding entity. It should be kept in mind that, in many countries, it is common practice to measure participating interests at cost in the company-only financial statements. The shift to net asset value in the Dutch holding entity may then be complex where the trade-off between usefulness to the user and the cost of providing the information (DAS 930.44) may be a valid reason for measuring at cost.

Another example of international entanglement is the situation where an intermediate holding entity does not hold 100% of the equity interests but rather only 30%, for example, with foreign group entities that value their equity interest at cost holding the remainder. In such a case, applying Article 2:389(1) NCC (measurement at net asset value according to the net asset value method) means that some kind of consolidation (i.e. determining the net assets per participating interest after eliminating any profit or loss from intercompany transactions) should still take place at the intermediate holding entity level. In such a case, a valid reason for deviating from Article 2:389(1) NCC could once again lie in weighing up the usefulness of this to the user against the cost of providing the information (DAS 930.44).

In the latter context, it is worth noting that the legislative history mentions Article 2:408 NCC and international entanglement as examples of valid reasons and that this list is therefore not exhaustive. However, the legislative history does indicate that the reason must be valid so that the freedom to deviate from Article 2:389(1) NCC does not go so far as to mean that a reason that need not be taken seriously would be sufficient (Parliamentary Papers II, 19813 no. 5).

The reasons for deviating from Article 2:389(1) NCC have to be disclosed in the notes (Article 2:389(9) NCC). When Article 2:389(9) NCC is applied to a participating interest in a group entity that is to be consolidated, a difference arises between the assets and profit or loss according to the consolidated and the company-only financial statements. This difference should be explained in the notes to the company-only financial statements.

Application of net asset value method in the case of different reporting dates
The reporting date of a participating interest may differ from that of the participating entity. The question is then the extent to which measurement can be based on the asset value (net asset value or visible equity) as at that different reporting date. The rule for consolidated financial statements is that, in certain circumstances, they may be prepared based on data that apply at a different date. However, that different date may not be more than three months before or after the reporting date (Article 2:412(2) NCC). Furthermore, movements that would distort the picture if not recognised then still have to be recognised (DAS 217.506). In our opinion, these provisions applicable to consolidated financial statements may be applied analogously to the measurement of participating interests with different reporting dates.

Entering net asset values according to IFRS-EU
On the basis of the last sentence of Article 2:362(8) NCC, an entity may, in its company-only financial statements, apply the accounting principles used in the consolidated financial statements according to IFRS-EU. This option effectively means that an entity may prepare its company-only financial statements according to the IFRS-EU accounting principles used in the consolidated financial statements. This does not include the measurement of consolidated participating interests. IFRS-EU requires such participating interests to be measured at cost, fair value (as per IFRS 9 "Financial Instruments") or according to the equity method in the company-only financial statements. According to the last sentence of Article 2:362(8) NCC, such participating interests may be measured at net asset value and the accounting principles used in the consolidated financial statements may be applied when entering net asset value. This will enable reconciliation to be maintained between equity in the company-only financial statements and equity in the consolidated financial statements. For example, in determining net asset value, goodwill acquired by a participating interest from third parties is not systematically amortised but is recognised in accordance with IFRS 3. See also paragraph 1.2.

Participating interest with properties leased within a group
If a consolidated participating interest owns a property and makes it available to the parent entity or to another consolidated participating interest, then, when applying the net asset value method, the parent company classifies the property owned by the consolidated participating interest as property for its own use in its company-only financial statements, in accordance with the classification used in the consolidated financial statements (DAS 214.338a). As a result, no differences occur between equity according to the consolidated financial statements and equity according to the parent entity's company-only financial statements. See also the explanation in paragraph 8.1.

9.2.7 Measurement at acquisition cost or current value

General
Participating interests in which no significant influence is exercised over operating and financial policy are measured in accordance with Article 2:384(1) NCC. The purchase price or current value are then considered as the basis of measurement. Measurement at acquisition cost means measurement at the amount paid to third parties when the participating interest was purchased including transaction costs (see paragraph 9.2.1). Measurement at current value means measurement at fair value (market value) (Article 10(1) of the Decree on current value). Where measurement is made at cost or current value, goodwill is not expressed separately, but continues to be included in the carrying amount in the participating interest's balance sheet.

However, if participating interests in which significant influence is exercised over their business and financial policy are not measured according to the net asset value method (on the basis of Article 2:389(9) NCC, see paragraph 9.2.6), only the acquisition cost may be used in this regard. This is because the Decree on current value does not allow participating interests in which significant influence is exercised (as referred to in Article 2:389(1) NCC) to be measured at current value (Article 10(3)(c) of the Decree on current value). This also means that subsidiaries and joint ventures may not be measured at current value.

Acquisition cost dependent on uncertain factors
It sometimes happens that the acquisition cost is not fixed at the time of acquisition, for example because the price depends (or depends in part) on uncertain factors such as future profit or loss. Or because the price could be adjusted at a later time. This is discussed in more detail in paragraph 31.3.7.

Profit or loss from participating interests
Where measurement is made at acquisition cost or current value, the dividend declared in the year under review (DAS 214.504) is recognised as revenue from the participating interest (apart from impairments). Non-cash dividends should be measured at fair value. The determination of this fair value should relate to the time the dividend is declared (exclusive of dividend).

Pre-acquisition dividend
Dividends deemed to have been included in the acquisition cost should not be recognised as income but deducted from the acquisition cost as pre-acquisition dividend (DAS 214.504). There could be pre-acquisition dividend if an entity buys a participating interest that already had profit reserves at the time of the acquisition. If these profit reserves are paid out as dividends fairly soon after the acquisition, this is considered pre-acquisition dividend.
DAS 270.133 defines pre-acquisition dividend as "(dividends) derived from assets and/or profit already constituted or earned before the acquisition of the investment". Pre-acquisition dividend is, in economic terms, not a benefit from the participating interest ("return on investment"), but in fact a (partial) repayment of the investment in the participating interest ("return of investment").

If dividends received in the periods prior to and after the acquisition can only be allocated in an arbitrary manner, they are then recognised as income, unless it is clear that those dividends received are in fact a repayment of the acquisition cost (DAS 270.133). With the passage of time after the takeover or acquisition, the objection to recognising pre-acquisition dividends as income usually gradually fades. Nevertheless, even after some years have passed, there could still be a so-called superdividend situation that bears no relation to the profitability or normal activities of the participating interest since the date of acquisition.

An entity should develop its own method for assessing whether this is income or repayment of the acquisition cost (pre-acquisition dividend) in accordance with DAS 270 and DAS 214, as appropriate.

Impairment
In the case of participating interests in which no significant influence is exercised, DAS 290 "Financial Instruments" applies (DAS 121.102). See paragraph 21.6.4.5 on impairment when measuring such participating interests at cost. When measured at current value, reductions in the participating interest's current value to below cost are recognised in the profit and loss account. See paragraph 21.6.4.5.

9.2.8 Valuation of other securities and other receivables

Other securities
The acquisition cost and current value come into play when measuring other securities classified as financial fixed assets (Article 2:384(1) NCC). See Chapter 21 on financial instruments for the measurement of securities (including bonds and securities). See paragraph 14.3.7 as regards whether a revaluation reserve should be created in the event of measurement at current value.

When equity interests are measured at cost, the dividend declared in the reporting year is credited to the profit or loss of the participating entity (DAS 214.504). Non-cash dividend distributions should be measured at fair value. The determination of fair value should relate to the time the dividend is declared (exclusive of dividend). Dividends deemed to have been included in the acquisition cost should not be recognised as income but deducted from the acquisition cost as pre-acquisition dividend (DAS 214.504).

Other receivables
See Chapter 21 on financial instruments for the measurement of receivables (pursuant to loans or otherwise) included in financial fixed assets.

9.3 Presentation and notes

9.3.1 Balance sheet

According to Article 2:367 NCC, the following are recognised separately under financial fixed assets:

- shares, share certificate for shares and other forms of participating interest in group entities;
- other participating interests;
- receivables from group entities;
- receivables from other entities and companies that have a participating interest in the entity or in which the entity has a participating interest;
- other securities;
- other receivables, with separate disclosure of receivables pursuant to loans and advances to members or holders of registered shares.

The principles of measurement and determination of profit or loss must be set out for every item of the financial fixed assets (Article 2:384(5) NCC). A combined explanation is sufficient for items measured in the same way.

Receivables from other entities or companies embodied in securities (e.g. bonds) that form part of the financial fixed assets are included in the item called Other securities of financial fixed assets, if they are intended to be held on a long-term basis (DAS 190.206).

Long-term receivables from group entities and participating interests embodied in bonds are not recognised as "other securities" but rather as "receivables from group entities" and "receivables from participating interests", respectively.

Where restructuring costs have been taken into account in determining the fair value of assets, provisions and debt at the time of acquisition of a participating interest, this should be disclosed in the notes. It is advisable to explain the nature and extent of restructuring costs taken into account (DAS 214.608).

9.3.2 Movement schedule

A movement schedule for each item of the financial fixed assets must be included pursuant to Article 2:368(1) NCC. The required insight may mean that movements need to be further explained (DAS 214.606). The Dutch Accounting Standards Board recommends including comparative figures from the previous financial year in the movement schedule if that is important to gain an understanding of the item in question (DAS 110.127).

Similarly, information on the aggregate of revaluations and the aggregate of amortisation and depreciation at the reporting date must be provided for each of the items included in the financial fixed assets (Article 2:368(2) NCC).

The profit or loss of participating interests measured using the net asset value method and any dividend declared by such interests should be shown separately in the movement schedules of the items Participating interests in group entities and Other participating interests (DAS 214.607). The movement schedule need not include comparative figures for the previous financial year (DAS 110.127).

9.3.3. Profit and loss account

Measurement according to the net asset value method
When applying the net asset value method, the change in the carrying amount of the investment since the previous financial statements due to the profit or loss generated by that investment is recognised as income. Its share in the participating interest's profit or loss can be recognised in the item included for this purpose in the formats, i.e. immediately after the Tax item and therefore after the Profit or loss before tax. Its share in the participating interest’s profit or loss may also precede all financial income and expenses (see Article 6(1) of the Decree on annual accounts format (*Besluit Modellen Jaarrekening*). In that case, this item is part of the Profit or loss before tax.

Measurement other than using the net asset value method
If interests are not measured using the net asset value method, the dividend declared by the participating entity in the year under review is credited to the participating entity's profit or loss. Dividends are recognised as the first item of financial income as 'distributions from participating interests not carried at net asset value and similar' (Article 7(4) of the Decree on annual accounts format).

Other revenue
Revenue from receivables and other securities included in financial fixed assets are recognised in the item Revenue from receivables included in fixed assets and from securities (DAS 214.505).

Profit or loss from sale of participating interests
A common presentation issue concerns the presentation of a profit or loss from the sale of participating interests. A profit from the sale of a participating interest may be presented as follows:

- as part of other revenue;
- as part of financial income and expenses; or
- as a separate item immediately after the share in profit or loss from participating interests.

A loss can be presented according to the latter two modes of presentation. Our preference is for the last of these three modes of presentation. The reason for this preference is that the profit or loss from the sale of participating interests is close in nature to the share in the profit or loss from participating interests. This means that the profit or loss from the sale of participating interests and the share in the profit or loss from participating interests are presented sequentially in the profit and loss account.

9.3.4 Data on equity interests

This paragraph deals with disclosures relating to equity interests that must be included in the notes to the company-only financial statements in accordance with Article 2:379 NCC. An entity may deposit the part of the notes containing these disclosures separately for inspection by any person at the office of the Trade Register, provided that the two parts of the notes refer to each other (Article 2:379(5) NCC).

The disclosures regarding equity interests required by Articles 2:379 and 414 NCC may be included jointly when preparing consolidated financial statements. See Annex 1 to this chapter for an explanation of such joint disclosures.

Pursuant to Article 2:379(1) NCC, a participating entity must state the name, principal place of business and the proportion of the issued capital of each company that has been provided:

- which it, alone or jointly with one or more subsidiaries, at its own expense, provides (or arranges to provide) at least one-fifth of the issued capital; or
- in which it, as a partner, is fully liable to the creditors for any debt.

Under this provision, the entity is only required to disclose equity interests in which it has in fact provided part of the capital itself. For example, in the situation where a subsidiary of an entity has a 20% interest in a participating interest, but the entity itself has no interest in that participating interest, the entity does not have to disclose information about this participating interest under this provision.

The entity also discloses, for each such company, the amount of equity and profit or loss according to its most recently adopted financial statements, unless (Article 2:379(2) NCC):

- the entity consolidates the company's financial data;
- the entity accounts for the company on its balance sheet or its consolidated balance sheet in accordance with Article 2:389(1) to (8) NCC;
- the entity does not consolidate the company's financial data due to an immaterial interest or pursuant to Article 2:408 NCC; or
- less than half of the company's capital is provided at the entity's expense and the company lawfully does not publish its balance sheet.

Data on equity as well as profit and loss are taken from the most recently available (i.e. adopted) financial statements. Any additional information should be provided about this in accordance with the insight required in this regard (DAS 214.611).

Each entity shall state in the notes (Article 2:379(3) NCC):

- the name and principal place of business of the company at the head of its group; and
- the name and principal place of business of each company that consolidates its financial data in its published consolidated financial statements, as well as the place where copies can be obtained at no more than cost.

The Minister of Economic Affairs may grant exemptions to the above obligations (Article 2:379(1), (2) and (3) NCC) if there is a well-founded fear that such disclosure could cause serious harm. The notes state that an exemption has been granted or applied for. Disclosure is not required pending any request in this regard (Article 2:379(4) NCC).

An entity that is a fully liable partner of a general partnership (VOF) or a limited partnership (CV) has unlimited liability for all debts of that partnership. To the extent needed for the insight referred to in Article 2:362(1) NCC, information on this unlimited liability should be given in the notes. If warranted, a provision should be created (DAS 214.617).

If necessary for the required insight, the entity states (if applicable) the circumstances on the basis of which (DAS 214.613a):

- a company to which it provides at least 20% of the issued capital has not been classified as a participating interest;
- a company to which it provides less than 20% of the issued capital has been classified as a participating interest;
- it does not exercise significant influence over a participating interest, even though it holds at least 20% of the voting rights; and
- it exercises significant influence over a participating interest, even though it holds less than 20% of the voting rights.

In certain circumstances, based on materiality criteria, details of relatively insignificant equity interests need not be disclosed (see also paragraph 2.10). See Annex 1 to this chapter for a schematic overview of the disclosures relating to equity interests.

9.3.5 Other securities

As regards the disclosure of other securities, see paragraph 21.10 regarding the disclosure of financial instruments.

9.4 Exemptions for small and medium-sized entities

There are no exemptions for medium-sized entities.

On the basis of Article 2:396 NCC, small entities are exempt from having to separately present the categories of financial fixed assets listed in Article 2:367 NCC.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ("over and above the legal minimum") in the notes.

9.5 Significant differences from IFRS

Measurement in the company-only balance sheet
In the so-called company-only financial statements (*enkelvoudige jaarrekening*), interests in related parties, joint ventures and subsidiaries (i.e. participating interests in which the entity exercises significant influence) should be measured at acquisition cost, fair value or according to the "equity method". The following entities prepare "company-only financial statements":

- entities that also prepare consolidated financial statements; and
- intermediate holding entities that avail themselves of the intermediate holding entity exemption provided by IFRS 10.4.

Art. 2:389 NCC prescribes net asset value as the basis of measurement, unless there are valid reasons for not applying it. In that case, a participating interest may only be measured at the acquisition cost (pursuant to Article 2:384(1) NCC and Article 10(3)(c) of the Decree on current value).

Presentation of goodwill
According to IAS 28, if an interest is measured according to the equity method, the initial measurement is equal to the acquisition cost (including any goodwill). Goodwill included in the measurement of this interest should not be amortised. According to Article 2:389 NCC, the initial measurement should be at net asset value (or as close to it as possible). Any goodwill is not recognised as part of net asset value but is recognised and presented separately. If goodwill is capitalised, it should be presented separately under intangible fixed assets. Any capitalised goodwill should then be amortised.

Negative goodwill
According to IAS 28, negative goodwill should be recognised immediately in the profit and loss account. There is negative goodwill if the acquisition cost is less than the net asset value at the time of initial recognition. This therefore means that, according to IAS 28, the initial measurement of the participating interest is then equal to the net asset value, and the difference with the acquisition cost (i.e. negative goodwill) is recognised as profit. DAS 214.336 provides that negative goodwill should be accounted for in the same way as provided by the directive on mergers and acquisitions (DAS 216.233-235). Due to restrictions relating in particular to the inclusion and measurement of identifiable intangible assets in the net asset value of the participating interest (restrictions that, incidentally, do not exist under IFRS), there is rarely any negative goodwill in participating interests in which an entity (merely) exercises significant influence.

Loss of significant influence over business and financial policies
An entity could potentially lose significant influence over the business and financial policies of an equity interest. In that case, such interests should be recognised as financial instruments within the scope of the provisions on financial instruments. According to DAS 214.321, the most recently known net asset value should be taken as the basis for further measurement of the participating interest at acquisition cost or fair value. IAS 28 provides that, in this situation, the equity interest is adjusted to fair value, with this adjustment being compared to the previous measurement and recognised in the profit and loss account.

Annex 1. Disclosure of equity interests (Articles 2:379 and 414 NCC)

If consolidated financial statements are prepared; overview of group relationships
A summary of the data required under Art 2:379 and 414 NCC:

Consolidated companies		
Name	Registered office	Share in the issued capital
...	...	...
...	...	...

Non-consolidated companies		
Name	Registered office	Share in the issued capital
...	...	...
...	...	...

The list of equity interests may be disclosed at the end of the notes to the financial statements.

Under Article 2:379(5) NCC, the list of equity interests may also be filed separately with the Trade Register with cross-references in the list and explanatory notes.

In the event of combined disclosures in the notes to the consolidated financial statements, in accordance with Articles 2:379 and 414 NCC, the following categories of companies should be distinguished (categories combined according to Article 2:379 and 414 NCC):

A. Legal entities and companies fully included in the consolidated financial statements.

B. Legal entities and companies included in the consolidated financial statements to an extent proportionate to the interest held in them.

C. Legal entities and companies in which a participating interest is held that is recognised in the consolidated financial statements pursuant to Article 2:389 NCC.

D. Unincorporated subsidiaries not already listed at A, B or C.

E. Legal entities and companies, included in full in the consolidation, or their subsidiaries, alone or jointly, provide or arrange to be provided, at their own expense, at least 20% of the issued capital and which have not already been disclosed in accordance with A, B or C.

F. The company that heads the group to which the entity belongs.

G. Any company that consolidates the financial data of the entity in its published consolidated financial statements.

The following data should be provided for each category:

1. Name and principal place of business.	A	B	C [3]	D	E	F	G [1]
2. Place where copies of consolidated financial statements incorporating the data of the entity can be obtained at no more than cost.							G [1]
3. Share in the issued capital.	A	B	C [3]	D	E		

4. Equity and profit in accordance with the most recently adopted financial statements.					E [2, 4]
5. Reason for consolidation, unless it is the ability to exercise a majority of the voting rights as well as being able to provide capital proportionate to that.	A				
6. Reason for consolidation in accordance with Article 2:409 NCC (proportional to interest).		B			
7. Reason for not consolidating a subsidiary (* if there is any subsidiary).			C*	D	E*
8. If a liability notice has been issued for the relevant entity pursuant to Article 2:403 NCC.	A				

[1]This fact is not disclosed if the relevant company lawfully does not disclose its interest in the entity (e.g. In the case of an exemption granted by the Minister of Economic Affairs).

[2]This fact is not disclosed in any of the following cases:

- the entity consolidates the company's financial data;
- the entity recognises the company on its balance sheet in accordance with Article 2:389(1) to (8) NCC (net asset value);
- the entity does not consolidate the company's financial data due to its immateriality or pursuant to Article 2:408 NCC (exemption from consolidation for intermediate holding entities);
- the entity provides less than 50% capital and the company lawfully does not publish its balance sheet.

A statement of the reason for non-disclosure is recommended but not required by law.

[3]According to Article 2:414(3) NCC, this disclosure may not be omitted if it is useful for the legally required insight even if the (related) participating interest is immaterial. This is almost always the case.

[4]This may be disclosed as follows: "According to the most recently adopted financial statements, ABC BV's equity was EUR 000,000 as at 31 December of year 2 (year 1: EUR 000,000) and its profit for financial year 2 was EUR 000,000 (year 1: EUR 000,000)".

The entity also discloses (in addition and in extension to Article 2:414(2)(a) NCC) why a company has or has not been included in the consolidated financial statements if this is not clear based on the equity interest held (DAS 217.601).

If company-only financial statements are prepared; statement of equity interests
If consolidated financial statements have not been prepared, the entity must, on the basis of Article 2:379 NCC, include disclosures in the notes to the company-only financial statements concerning the following categories of companies:

A. Companies to which the entity, alone or jointly with one or more subsidiaries, at its own expense, provides or arranges to be provided at least 20% of the issued capital.

B. Companies in which the entity is fully liable as a partner to creditors for any debt.

C. (Every) company at the head of the group to which the entity belongs.

D. (Every) company that consolidates the financial data of the entity in its published consolidated financial statements.

The following data should be provided for each category:

Name and principal place of business.	A	B	C [2]	D [2]
Place where copies of consolidated financial statements incorporating the data of the entity can be obtained at no more than cost.				D [2]
Share in the issued capital.	A	B		
Equity and profit in accordance with the most recently adopted financial statements.	A[1, 3]	B[1, 3]		

[1]This fact is not disclosed in the following instances:

- the entity consolidates the company's financial data;
- the entity recognises the company on its balance sheet in accordance with Article 2:389(1) to (8) NCC (net asset value);
- the entity does not consolidate the company's financial data due to its immateriality or pursuant to Article 2:408 NCC (exemption from consolidation for intermediate holding entities);
- the entity provides less than 50% capital and the company lawfully does not publish its balance sheet.

[2]This fact is not disclosed if the relevant company lawfully does not disclose its interest in the entity (e.g. exemption granted by the Minister of Economic Affairs).

[3]This may be disclosed as follows: "According to the most recently adopted financial statements, ABC BV's equity was EUR 000,000 as at 31 December of year 2 (year 1: EUR 000,000) and its profit for financial year 2 was EUR 000,000 (year 1: EUR 000,000)".

It should be noted that Article 2:379 NCC does not require the various types of interests to be classified in the notes to the company-only financial statements according to the distinct categories of companies listed above. This distinction is made in order to clarify which data should be disclosed for each category.

10 Impairment of fixed assets

10.1 Introduction

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount (DAS 121.0). This chapter looks at impairment losses of fixed assets as referred to in Article 2:387(3) NCC and the reversal of impairment losses as referred to in Article 2:387(4) NCC. DAS 121 provides guidance on how to determine and recognise impairments of fixed assets.

This chapter is about fixed assets, irrespective of whether they are measured at cost, at current value or at net asset value. It does not apply to financial instruments in scope of DAS 290 'Financial instruments', nor does it apply to deferred tax assets (DAS 272 'Income taxes'). If tangible and intangible fixed assets are measured at current value, their current value is either current cost, value in use or net selling price (Article 7 BAW). The frame of reference for a potential impairment is the carrying amount of an asset irrespective of the chosen measurement basis.

10.2 Identifying impairments

An entity is required to assess, at each reporting date, whether there are any external or internal indications that an asset may be impaired. DAS 121.203 lists a number of indications that are to be included in the assessment as a minimum. Besides being alert to the indications of DAS 121, an entity should also be critical of any other relevant events and information. Their impact on the measurement of fixed assets will have to be determined time and time again. An entity should document the assessment of the fixed assets measurement.

External indications of impairment
In assessing whether an asset may be impaired, an entity must consider the following external indicators (DAS 121.203):

- there are observable indications that the asset's market value has declined to a significantly higher degree during the reporting period than would be expected as a result of the passage of time or normal use;
- significant changes with an adverse effect on the entity have taken place during the reporting period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market where the relevant asset is used;
- market interest rates or other market return requirements on investments have increased during the period, and those increases are likely to affect the discount rate, thereby affecting the recoverable amount to a significant degree; and
- the carrying amount of the entity's net assets exceeds the market value of the outstanding share capital.

If market interest rates or other market return requirements have increased, the entity is not required to determine an asset's recoverable amount if the discount rate is unlikely to be affected by the increase or if the discount rate *is* likely to be affected by the increase, but it is unlikely that there will be a material decrease in the recoverable amount (DAS 121.204).

Internal indications of impairment
In assessing whether an asset may be impaired, an entity must consider the following internal indicators (DAS 121.203):

- evidence is available of economic obsolescence or physical damage to an asset;
- significant changes with an adverse effect on the entity have taken place during the reporting period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include plans to discontinue or restructure the activities to which an asset belongs, plans to dispose of an asset before the previously expected date; and
- evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

Evidence from internal reporting that indicates that an asset may be impaired includes the existence of (DAS 121.205):

- cash flows for acquiring and/or using and/or maintaining an asset that are significantly higher than those originally budgeted;
- net cash flows or operating profits or losses that are (significantly) worse than those budgeted;
- a significant decline in budgeted net cash flows or operating profits or losses, or a significant increase in the expected loss; and
- a negative net cash flow or operational losses for the asset when preparing the current period figures and the budgeted figures for the future.

Correlation between impairment loss and enterprise value as a whole
The indications can show that an asset may be impaired without the company as a whole necessarily finding itself in a loss-making situation. This can occur if a company has multiple cash-generating units. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows during continuing use that are largely independent of the cash inflows from other assets or groups of assets (DAS 121.0). If the present value of the future cash flows are not sufficient to cover the future depreciation (or amortisation) of the cash-generating unit, then generally (i.e. unless the net selling price is higher) the cash-generating unit is impaired. Its recoverable amount is lower than its carrying amount because the positive cash flows prove to be lower than initially estimated. This is an indication of impairment that can be inferred from such sources as internal management reports.

10.3 Determining the recoverable amount

If an indication exists that an asset may be impaired, an entity is required to estimate the asset's recoverable amount (DAS 121.202). Such an indication may also point to the fact that the remaining life, the depreciation (amortisation) method or the residual value for the asset needs to be reviewed (DAS 121.206).

The recoverable amount is the higher of the net selling price and the value in use (DAS 121.0). This applies both when measurement is at cost or at current value (pursuant to Article 7 BAW). If it is not possible to estimate the recoverable amount of the individual asset, an entity must determine the recoverable amount of the cash-generating unit (CGU) to which the asset belongs.

10.3.1 Net selling price

Net selling price represents the maximum amount at which an asset (or a CGU) can be sold, less the costs to be incurred (Article 5 BAW). Net selling price is also referred to as direct realisable value. The net selling price is determined based on a sales contract or a market price as determined in a liquid (active) market, adjusted for costs yet to be incurred. Examples of such costs are production costs of work in progress and selling costs (Explanatory Memorandum to BAW). Termination fees and costs associated with reducing or reorganising a business following the disposal of an asset are not included herein.

10.3.2 Value in use

Value in use represents the present value of estimated future cash flows attributable to an asset or combination of assets that can be obtained from the operation of the business (Article 3 BAW). Value in use is also referred to as indirect net realisable value. Estimating an asset's value in use involves the following steps: estimating the future cash inflows and outflows during continuing use of the asset and from its ultimate disposal and applying the appropriate discount rate to those estimated future cash flows. The determination of value in use depends on estimates of future cash flows and discount rates. These are subjective by nature. A change of just one percent in the discount rate can have a significant effect on the final estimate.

10.3.2.1 Accounting principles for estimating future cash flows

DAS 121 sets out a number of principles an entity is required to follow when determining value in use.

Principles for calculating value in use
The following elements must be reflected in the calculation of an asset’s value in use:

- an estimate of the future cash flows the entity expects to derive from the asset (or CGU);
- the time value of money, represented by the current risk-free interest rate;
- expectations about possible variations in the amount or timing of these estimates;

- the uncertainty inherent in the asset (or CGU); and
- other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows.

The last three elements can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate.

Techniques for calculating present value
The first technique is the 'traditional approach', which assumes that the discount rate can incorporate all the expectations about the cash flows and the risk premium. Therefore, the traditional approach places the emphasis on selection of the discount rate. In the traditional approach, the last three elements listed above are incorporated into the discount rate. The traditional approach is easy to apply for marketable assets, given that there will be a market interest rate that can serve as the discount rate. However, this approach may not appropriately address non-marketable, non-financial assets. The discount rate must then be determined based on estimates and adjustments.

The second technique is the 'expected cash flow approach'. The expected cash flow approach uses all expectations about possible cash flows instead of the single most likely cash flow. The expected cash flow approach focuses on analysing the cash flows and the underlying assumptions. Elements 3, 4 and 5 of value in use listed above are recognised in the cash flows. As a consequence, the expected cash flow approach requires an entity to develop multiple cash flow scenarios with probabilities (in percentages). The advantage of the expected cash flow approach is that it makes risks transparent and measurable through scenarios. It also allows an entity to take account of any uncertainty in the timing of cash flows. That said, the application of the expected cash flow approach should be subject to a cost-benefit analysis. This approach is laborious. The required data need to be available and processed. Whichever approach an entity adopts, the result should reflect the weighted average present value of all possible outcomes.

Other principles
DAS 121.310 also refers to the following principles that are of importance when estimating future cash flows. An entity should:

- base cash flow projections on reasonable and supportable assumptions that represent management’s best estimate of the economic conditions that will exist over the remaining life of the asset (or CGU). Greater weight should be given to external information because it is considered more reliable than internal information;
- base cash flow projections on the most recent approved budgets. Projections based on these budgets should cover a maximum period of five years, unless a longer period can be justified; and
- as reliable and detailed cash flow projections are generally not available for the period beyond five years, estimate cash flow projections beyond the period covered by the most recent budgets by extrapolating the projections based on the budgets using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate may not exceed the long-term average growth rate for the products, industry or country (or countries) in which the entity operates, or for the market in which the asset (or CGU) is used, unless a higher rate can be justified.

10.3.2.2 Composition of estimates of future cash flows

Estimates of future cash flows should include (DAS 121.311):

- estimated cash flows during continuing use of the asset (or CGU);
- estimated cash outflows that are necessarily incurred to generate the cash flows and that can be directly attributed or allocated on a reasonable and consistent basis; and
- the estimated net cash flow in the event of disposal of the asset (or CGU) at the end of its useful life.

Impact of future restructurings and investments
Future cash flows should be estimated for the asset (or CGU) in its current condition. The estimates should not reflect future cash inflows or outflows that are expected to arise from a future restructuring to which an entity is not yet committed. Estimates of future cash flows include expenditures necessary to maintain or sustain an asset at its original capacity. They do not include future investments that will improve or enhance the asset's original capacity (DAS 121.313). This restriction does not apply when determining the net selling price of an asset (or CGU).

Cash inflows or outflows from financing activities
Cash flows should not include cash inflows or outflows from financing activities, such as interest income, borrowing costs, or income tax receipts or payments (DAS 121.318). This is to avoid the effects of some assumptions being double-counted or ignored. Given that the present value of the cash flows is considered by discounting, these cash flows exclude cash flows from financing activities.

Cash inflows or outflows from taxes
Similarly, since the discount rate is determined on a pre-tax basis, future cash flows are also estimated on a pre-tax basis (DAS 121.319). The use of pre-tax cash flows also prevents tax effects (including the effect of unused tax losses) from resulting in double-counting, given that tax positions are presented separately in the balance sheet. In short, the requirement to use pre-tax cash flows to determine value in use is intended to allow an entity to perform as accurate an assessment as possible of an asset's recoverability without the effects of taxes.

Overhead
Furthermore, cash flows should include future overhead that can be directly attributed to the use of the asset, or that can be allocated to the use of the asset in a reasonable and consistent manner.

Residual value
The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its life should be the amount that an entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, independent parties, after deducting the expected costs of disposal or costs to prepare the asset for sale (DAS 121.320).

Currency unit
Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency so as to allow comparison between the recoverable amount and the carrying amount in the same currency (DAS 121.322). An entity translates the present value of the future cash flows using the exchange rates applicable on the date of the value in use calculation (DAS 121.322).

10.3.2.3 Discount rate

Basis for determining the discount rate
The discount rate is a pre-tax rate that reflects the current market interest rate as well as the risks specific to the asset. The discount rate should not reflect risks for which future cash flows have been adjusted (DAS 121.323). When an asset-specific rate is not directly available from the market, an entity uses other bases to determine the discount rate. The purpose is to determine the best possible market assessment of the time value of money for the period until the end of the asset's life and the risk that the future cash flows will differ in amount and timing from the estimates (DAS 121.325). As a starting point, the entity may choose from the following rates (DAS 121.326):

- the entity's weighted average cost of capital;
- the entity's incremental borrowing rate; or
- other market interest rates.

Choosing one of these rates can have a major impact on the amount of value in use. The rate is adjusted to reflect the way that the market would assess the specific risks associated with the projected cash flows and to exclude risks that are not relevant to the projected cash flows. Consideration is given to risks such as country risk, currency risk, price risk and cash flow risk. To avoid double-counting, the discount rate does not reflect risks for which future cash flows have been adjusted. If the entity uses nominal (real) cash flows in its calculation, it should also use a nominal (real) discount rate.

Given that the entity uses pre-tax cash flows in its calculation, it should also use a pre-tax discount rate (DAS 121.326). Therefore, when the basis for determining the rate is post-tax, that basis is adjusted to reflect a pre-tax rate. To adjust the post-tax discount rate to a pre-tax rate, the entity should perform grossing-up calculations. If the timing of cash flows for tax and accounting purposes arising is the same (one condition being that depreciation (amortisation) for tax purposes corresponds to depreciation (amortisation) for accounting purposes), the post-tax discount rate can normally be grossed up against the applicable tax rate.

The pre-tax discount rate and the post-tax discount rate grossed up against the tax rate will then result in the same value in use. This is not typically the case, however. Where it is not, grossing up the post-tax discount rate will not result in the same value in use as the value in use based on a pre-tax discount rate. This is one of the reasons why DAS 121 stipulates that entities are required to determine the pre-tax discount rate.

An entity normally uses a single discount rate for the estimate of an asset's value in use. However, an entity uses separate discount rates for different periods where value in use is sensitive to a difference in risks for different periods or to the structure of interest rates (DAS 121.327).

Weighted average cost of capital (WACC)
Weighted average cost of capital (WACC) is calculated as follows:

WACC = Ecr * (Emv / Temv) + Lcr * (1 – t) * (Lmv / Tmv), where:		
Ecr	=	Equity cost rate
Lcr	=	Liabilities cost rate
Emv	=	Equity market value
Lmv	=	Liabilities market value
Tmv	=	Total market value (= Emv + Lmv)
t	=	Effective tax rate / 100

The cost rate of equity is typically determined using the capital asset pricing model (CAPM). The formula is as follows:

Ecr = Rf + BetaLev * (Mr – Rf), where:		
Rf	=	Risk-free return
Mr	=	Market return
Mr – Rf	=	Market risk premium
BetaLev	=	A measure of an asset's systematic risk (average: 1.0), making allowance for the company's capital structure. The beta measures the expected sensitivity of an equity instrument's return, e.g. a share, to overall changes in market return. A beta value of 1.5 for a share means that, if the market as a whole rises by 10%, the value of the share is expected to rise by 15%. Shares with betas above 1.0 will move with more momentum than shares with betas between 0 and 1.0. If a share's beta is 0, it will not be sensitive to market developments at all. In exceptional cases where a share's beta is negative, the share and the market will move in opposite directions.
BetaLev = BetaUnlev * (1 (1 - t) * (Emv / Temv), where BetaUnlev assumes that the company has been entirely financed with equity. Lev stands for 'leveraged' and Unlev for 'unleveraged'.		

This discount rate can be estimated from the WACC of a listed company that has a single asset (or a portfolio of assets) similar in terms of capacity and risks (DAS 121.324). When an asset-specific rate is not directly available from the market, an entity can use its own WACC as a basis for determining the eventual discount rate (DAS 121.326).

10.4 Determining and recognising impairments

10.4.1 Determining and recognising impairment of an individual asset

If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset should be reduced to its recoverable amount (DAS 121.401). That reduction is an impairment loss in accordance with Article 2:387(3) NCC.

Under Article 2:387(4) NCC, an impairment loss should be recognised as an expense in the profit and loss account immediately, unless the asset has been measured at current value. An impairment loss on a revalued asset is recognised against the revaluation reserve to the extent that upward adjustment of the relevant assets was taken to the revaluation reserve (Article 2:390(3) NCC).

In accordance with the requirements of DAS 270, an impairment loss is charged directly to 'other changes in the value of intangible and tangible fixed assets' in the profit and loss account.

When the amount estimated for an impairment loss exceeds the carrying amount of the asset to which it relates, an entity will recognise a liability if that is required by DAS 252 'Provisions' (DAS 121.403). For more details, see Chapter 16.

After the recognition of an impairment, the depreciation (amortisation) charge for the asset is adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining economic life (DAS 121.404).

10.4.2 Determining and recognising impairment of a cash-generating unit

If it is not possible to estimate the recoverable amount of the individual asset, an entity must determine the recoverable amount of the cash-generating unit (CGU) to which the asset belongs (DAS 121.501).

10.4.2.1 Identifying the cash-generating unit to which an asset belongs

The recoverable amount of an individual asset cannot be determined if the asset does not generate cash inflows during continuing use that are largely independent of those from other assets. In such cases, value in use and, therefore, the recoverable amount, can be determined only for the cash-generating unit to which the asset belongs (DAS 121.502). A cash-generating unit is the smallest identifiable group of assets that generates cash inflows during continuing use that are largely independent of the cash inflows from other assets or groups of assets (DAS 121.0). This definition has a number of key elements.

Smallest identifiable group of assets
Impairment tests are performed for the smallest possible group of assets for which it can be determined that they generate cash inflows independently. This is to ensure that individual assets are tested for impairment as much as possible to prevent impairment of individual assets from going undetected if the test comprises too large a group of assets. Impairment of an asset will then be offset by an increase in the value of another asset in that group. This does not do justice to the individual measurement of assets during continuing use. Cash inflows from continuing use are inflows of cash and cash equivalents eventually received from parties outside the entity or cash inflows received from other group entities (DAS 121.503). If the use of the asset is not continued, it is measured at its net selling price rather than its value in use.

Independent of cash inflows from other assets or groups of assets
In identifying whether cash inflows are largely independent of the cash inflows from other assets (or groups of assets), an entity should consider various factors including how management monitors the entity's operations (e.g. via product lines, activities, individual locations, districts or regions) or how management makes decisions about continuing or disposing of the entity's assets and activities (DAS 121.503).

In a general sense, incoming cash flows will be an important input factor for the entity's management in making strategic decisions about whether to continue or dispose of the entity's assets and operations. However, a cash-generating unit is briefly defined as the smallest identifiable group of assets that generates independent cash inflows. This means that it depends on the actual situation of assets that generate incoming cash flows, and is not a result of how management monitors or controls the activities. However, the way in which the entity's management monitors or directs operations may provide clues as to which incoming cash flows are independent of other incoming cash flows in the economic reality.

Internal activities for which there is an active market
If an active market exists for the output produced by an asset or group of assets, this asset or group of assets should be identified as a cash-generating unit, even if some or all of the output is used internally (DAS 121.504). Even if part or all of the output produced by an asset or a group of assets is used by other units of the entity (e.g. semi-finished products in a production process), this asset or group of assets forms a separate cash-generating unit if the entity could sell the output on an active market. This is because the asset or group of assets could generate cash inflows during continuing use that would be largely independent of the cash inflows from other assets or groups of assets (DAS 121.505).

Concentric structure of cash-generating units
If the criteria listed above are met, the following assets may qualify as a cash-generating unit:

- a group of assets (e.g. a machinery group, an assembly line);
- a single department within an entity (e.g. production department A);
- a group of departments within an entity (e.g. multiple departments involved in a production process);
- a group entity engaging in a single activity;
- a group of entities within a group that have divided the sub-activities among them such that the group of entities is responsible for carrying out the activity as a whole; or
- a group as a whole. This is the case for example, when a group engages in only one activity, but has placed various assets and/or subactivities to carry out that activity in separate entities. For example, a manufacturing entity that has placed its buildings in a separate real estate entity.

To clarify this, four specific examples have been worked out.

Example: Identifying cash-generating units (1)

Appendix 1 of DAS 121 provides an example of a company with two plants (X and Y). X manufactures a semi-finished product that is sold to Y. Y uses the product as a raw material in its finished product. X's products are sold to Y at an arm's length price. 80% of Y's finished products are sold to third parties. 60% of X's finished products are sold to Y and the remaining 40% are sold to third parties.

The following two mutually exclusive situations are deemed to exist:

Situation 1: there is an active market for the products X sells to Y. The internal transfer prices are higher than the market prices.

Situation 2: there is no active market for the products X sells to Y.

Situation 1

X can sell its products in an active market, generating cash flows that are largely independent from Y's cash flows. Therefore, it is likely that X is a separate cash-generating unit, even though part of its production is used by Y (see DAS 121.504). It is likely that Y is also a separate cash-generating unit. Y sells 80% of its products to third parties. Therefore, the cash flows can be considered to be largely independent. Internal transfer prices do not reflect market prices for X's output. Therefore, in determining value in use of both X and Y, the entity adjusts the budgets to reflect management's best estimate of future market prices for those of X's products that are used internally (see DAS 121.504).

Situation 2

It is likely that the recoverable amount of each plant cannot be assessed independently from the recoverable amount of the other plant because the majority of X's production is used internally and cannot be sold in an active market, which means that X's cash flows depend on Y's demand. Therefore, X cannot be considered a unit generating cash flows that are largely independent from Y. In addition, the two plants are managed together. As a consequence, it is likely that X and Y together comprise the smallest group of assets generating largely independent cash flows.

Example: Identifying cash-generating units (2)

A plant is buying up surrounding land and residential properties. The purpose of doing so is to prevent potential future environmental and other complaints from local residents. The residential properties will be demolished and the land will remain undeveloped.

Does the land qualify as a cash-generating unit?

The land was not bought with the purpose of generating independent revenues, but to protect the plant from potential environmental and other complaints. Given this purpose, the undeveloped nature of the land classifies it as 'for continuing use'. Since no independent cash inflows are generated from this continuing use, the acquired land does not qualify as an independent cash-generating unit under DAS 121.502a, irrespective of the fact that the land is the smallest identifiable asset and can be sold on an active and separate market. Potential impairments are recognised for the cash-generating unit to which the land belongs, which possibly is the plant as a whole.

Example: Identifying cash-generating units (3)

A listed company operates in three primary segments, i.e. food production, beverage production and retail shops. In its retail segment, the group has about 150 shops in 15 different countries around the world. The group has multiple shops in most countries. The shops were either acquired separately or started up by the group itself. Goodwill arose at each acquisition; this goodwill represents the market share of the respective shop. The group has a separate management committee in each country that makes decisions about investments and internal/external growth, and is responsible for managing the shops. Specific internal management reports exist at individual shop level. There is no particular synergy between the individual shops. The shops do not operate under a specific brand name. The group's operations are managed at country level. Investment decisions are mainly based on an assessment of the economic situation in a specific country.

The group has the following secondary segments: North America, South America, Africa, Europe and Asia.

Do the shops qualify as cash-generating units?

Although the organisation is managed at country level, the individual shops meet the definition of a cash-generating unit under DAS 121. For this reason, each individual shop qualifies as a cash-generating unit.

Example: Identifying cash-generating units (4)

A supermarket chain has a number of distribution centres that are closely related in terms of procurement planning and supermarket supplies. On 1 July of year 1, management decided to close one of the distribution centres (centre A). After a six-month transition period, centre A was vacated on 1 January of year 2. At that time, it was ready to be let or sold, and no longer included in the daily procurement and supply schedules. Management is still considering whether to let or sell centre A.

Until 1 January of year 2, centre A is closely related to the other distribution centres and does not generate independent cash inflows. From 1 January of year 2 onwards, the status of centre A will change; its carrying amount will have to be recovered from rental income and/or a potential sale. As a result, centre A will in fact generate independent cash inflows.

10.4.2.2 Recoverable amount and carrying amount of a cash-generating unit

The carrying amount of a cash-generating unit is determined on a basis consistent with the way the recoverable amount of the cash-generating unit is determined (DAS 121.508).

Carrying amount of a cash-generating unit
The carrying amount of a cash-generating unit includes the carrying amount of only those assets that can be allocated directly, or on a reasonable and consistent basis, to the cash-generating unit and that will generate the estimated future cash inflows. The carrying amount of a cash-generating unit does not include the carrying amount of any recognised liability, unless the recoverable amount of the cash-generating unit cannot be determined without

consideration of this liability (DAS 121.509). This is because net selling price and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and excluding liabilities that have already been recognised in the financial statements.

Where assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate the relevant stream of cash inflows. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment has occurred. In some cases, although some assets contribute to the estimated future cash flows of a cash-generating unit, they cannot be allocated to the cash-generating unit on a reasonable and consistent basis. This might be the case for goodwill, as described in paragraph 10.4.3, or for corporate assets such as head office assets, as described in paragraph 10.4.4 (DAS 121.510).

10.4.2.3 Manner of allocating impairment of a cash-generating unit

An impairment of a cash-generating unit is allocated first to its goodwill (if any) and then to its other assets *pro rata* on the basis of the carrying amount of each of its assets (DAS 121.520). In allocating an impairment, the carrying amount of an asset should not be reduced below the highest of its net selling price (if determinable), its value in use (if determinable) and zero. The amount of the impairment that would otherwise have been allocated to the asset should be allocated to the unit's other assets on a *pro rata* basis (DAS 121.521).

10.4.3 Determining and recognising goodwill impairment

Goodwill arising on acquisition represents a payment made by the acquirer in anticipation of future economic benefits. These benefits may result from synergy effects or from acquired assets that individually do not qualify for recognition in the financial statements, e.g. the knowledge present in the acquired company. Goodwill does not generate cash inflows independently from other assets or groups of assets and, therefore, the recoverable amount of goodwill as an individual asset cannot be determined. As a consequence, net selling price and value in use are determined for the cash-generating unit to which the goodwill belongs. The higher of these two amounts is then compared to the carrying amount of this cash-generating unit. This test only needs to be performed if there is an indication that goodwill may be impaired.

Goodwill acquired in a business combination should be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination (DAS 121.514). These may in effect be existing cash-generating units of the acquirer, irrespective of whether assets of the acquiree are assigned to those units. Each unit or group of units to which the goodwill is so allocated (DAS 121.514):

- should represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
- should not be larger than an operating segment as defined in DAS 350 'Segment information' (see paragraph 30.6).

Example: Allocating goodwill to cash-generating units (1)

An entity acquires a chain of five shops.

If the entity intended to buy the chain's brand, goodwill should be allocated to the brand. The cash flows from all five shops can be included in assessing goodwill measurement.

If the entity intended to buy two shops in prime locations, goodwill should be allocated to these two shops. Only the cash flows from these two shops should be included in assessing goodwill measurement.

Example: Allocating goodwill to cash-generating units (2)

A company produces different types of paper-based packaging materials, i.e. rolls, cardboard and cardboard boxes. Each activity represents a segment. The group takes over a paper mill and pays goodwill at acquisition. The paper mill recycles paper to produce the main raw material for the three types of packaging materials the group produces. The paper mill sells both to the group and to third parties. The acquisition results in synergy effects for the company's existing activities.

Does the goodwill paid have to be allocated to the paper mill only?

Goodwill should not just be allocated to the acquired paper mill. It should also be allocated to the acquirer's cash-generating units, since goodwill acquired in a business combination should be allocated to each of the acquirer's cash-generating units that benefit from the synergies of the combination, irrespective of whether assets of the acquiree are assigned to those units.

Example: Goodwill impairment test

At the end of year 1, entity M acquired 100% of entity Z for an amount of 3,000. Z has three plants, each of which is classified as a cash-generating unit (A, B, and C) under DAS 121.514. These plants represent the lowest level within M at which goodwill is tested for internal management purposes. The fair values of the plants' identifiable assets and liabilities are 1,200, 800 and 400 respectively, totalling 2,400. M recognises goodwill of 600 (i.e. 3,000 – 2,400) in respect of Z. The goodwill is amortised over four years.

Tax effects are ignored in this example.

At the date of acquisition of Z, the total fair values of the identifiable assets and liabilities of A, B and C are considered a reasonable basis for a *pro rata* allocation of the goodwill to A, B and C.

Goodwill is allocated as follows:

	A	B	C	Total Z
End of year 1				
Fair value	1,200	800	400	2,400
Pro rata	50%	33%	17%	100%
Pro rata allocation of goodwill	300	200	100	600

At the end of year 2, plant A incurs a significant loss. This loss is an indication of impairment. As a result, M is required to determine A's recoverable amount. The recoverable amount is the higher of net selling price and value in use. A's net selling price is 1,000; its value in use is 1,400. M therefore sets A's recoverable amount at 1,400.

At the end of year 2, A's carrying amount is 1,300 (excluding allocated goodwill). The carrying amount of the goodwill that was allocated to A is then 225 (i.e. 300 – 0.25 x 300).

In accordance with DAS 121.514, M will compare A's recoverable amount to A's carrying amount, including the carrying amount of goodwill allocated to A at acquisition:

	A
Carrying amount including allocated goodwill	1,525
Recoverable amount	1,400
Impairment loss	125

M will recognise an impairment loss of 125 for A. The loss is fully allocated to goodwill in accordance with DAS 121.520.

There are no indications of impairment losses for plants B and C at the end of year 2. Therefore, under DAS 121.202, M is not required to determine the recoverable amounts of these plants at the end of year 2.

10.4.4 Special provisions on goodwill allocation

The Dutch Accounting Standards include a number of special provisions on the allocation of goodwill. These relate to:

- the allocation of goodwill upon disposal of part of a cash-generating unit; and
- the allocation of goodwill in the event of a change in cash-generating units due to restructuring.

10.4.4.1 Disposal of part of a cash-generating unit

If goodwill has been allocated to a cash-generating unit and the entity disposes of an activity within that unit, goodwill should be allocated to that activity when determining the gain or loss on disposal (DAS 121.515). As a result, when an activity within a cash-generating unit is disposed of, part of the goodwill allocated to that unit is written off. The amount is determined on the basis of the relative values of the activity disposed of and the other activities of the cash-generating unit, unless the entity can demonstrate that some other method better reflects the goodwill associated with the activity disposed of.

Example: Allocating goodwill on disposal of an activity

A group produces different types of paper-based packaging materials, i.e. rolls, cardboard and cardboard boxes. Each type of product represents a segment. The group acquired a paper mill in year 1 and paid goodwill at acquisition. The paper mill recycles paper to produce the main raw material for the three types of packaging materials the group produces. The paper mill sells both to the group and to third parties. The acquisition resulted in synergy effects for the entity’s existing activities. As a consequence, at acquisition, goodwill was allocated not only to the acquired paper mill, but also to the cash-generating units of the acquiring group (see paragraph 10.4.3).

In year 2, the production line where paper is processed into pulp (part of the paper mill) is sold. Part of the goodwill that was allocated to the paper mill in year 1 is allocated to the disposal of the pulp production line. The amount of goodwill associated with the sold pulp production line is measured on the basis of the relative values of the production line and the portion of the paper mill that was retained.

10.4.4.2 Change in cash-generating units

If, due to restructuring, an entity changes the composition of one or more cash-generating units to which goodwill has been allocated, the goodwill should be reallocated to the (new) units (DAS 121.516). This reallocation should likewise be determined based on the relative values of the respective units, unless the entity can demonstrate that some other method better reflects the goodwill associated with the new units.

10.4.5 Corporate assets

Special provisions apply to corporate assets that are used by multiple cash-generating units, such as headquarters buildings, automation systems or research centres. An entity's structure determines whether an asset meets the definition of 'corporate assets' for a particular cash-generating unit. Key characteristics of corporate assets are that they do not generate cash inflows independently and their carrying amount cannot be fully attributed to the cash-generating unit under review (DAS 121.517). As a consequence, similar to goodwill, corporate assets should be allocated to cash-generating units, but only to the extent that there is a reasonable and consistent basis for such allocation (DAS 121.519). In that case, the entity only needs to perform an impairment test for the cash-generating unit under review. If corporate assets cannot be allocated on a reasonable and consistent basis, the impairment test should be performed in two steps:

- a test of the cash-generating unit without allocating the corporate assets for which there is no reasonable and consistent basis; and
- a test of the smallest group of cash-generating units to which the corporate assets *can* be allocated on a reasonable and consistent basis.

Example: Impairment of cash-generating units

A company has three cash-generating units (CGUs): A, B and C. There has been a significant change in the market; this change had an adverse effect on CGU A. Therefore, the company performs an impairment test for CGU A. The carrying amounts of A, B and C are 100, 150 and 200, respectively. The company operates from a headquarters. The carrying amount of the headquarter assets is 200: a headquarters building of 150 and a research centre of 50. The relative carrying amounts of the CGUs are a reasonable indication of their use of the headquarters building. The carrying amount of the research centre cannot be allocated on a reasonable and consistent basis to the CGUs. The remaining economic life of A is 10 years. The remaining economic lives of B and C are 20 years.

The carrying amount of the headquarters building is allocated to the carrying amount of the CGUs. A weighted allocation basis is used because the remaining economic life of A is 10 years, whereas the remaining economic lives of B and C are 20 years.

	CGU A	CGU B	CGU C	Total
Carrying amount	100	150	200	450
Remaining economic life	10 years	20 years	20 years	
Weighting based on remaining economic life	1	2	2	
Carrying amount after weighting	100	300	400	800
Allocation factor of carrying amount building	12% (= 100 / 800)	38% (= 300 / 800)	50% (= 400 / 800)	100%
Allocation of carrying amount building	18 (= 12% x 150)	57 (= 38% x 150)	75 (= 50% x 150)	150
Carrying amount after allocation of carrying amount building (excluding research centre)	118 (= 100 + 18)	207 (= 150 + 57)	275 (= 200 + 75)	600

The impairment test of CGU A is performed by:

- comparing the recoverable amount of CGU A to its carrying amount of 118 (excluding the research centre); *and*
- comparing the sum of the recoverable amounts of CGUs A, B and C to their total carrying amount of 650 (i.e. 600 plus 50 for the carrying amount of the research centre).

10.5 Reversing an impairment

Article 2:387(5) NCC sets out the requirements for reversing an impairment loss. At each reporting date, an entity should assess whether there is any indication that an impairment loss recognised in prior reporting periods no longer exists or has decreased. If any such indication exists, the entity should estimate the recoverable amount of that asset (or cash-generating unit) (DAS 121.602). In assessing whether there is any indication that an impairment loss recognised in prior reporting periods no longer exists or has decreased, the entity should consider the indications set out in paragraph 10.2 (DAS 121.603).

An impairment loss recognised for an asset in prior reporting periods should only be reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If this is the case, the carrying amount of the asset should be increased to its recoverable amount (DAS 121.605), but not higher than to the carrying amount described in paragraph 10.5.1. That increase is a reversal of an impairment loss. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or sale, since the date when an entity last recognised an impairment loss for that asset. An entity is required to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include (DAS 121.606):

- a change in the basis for recoverable amount (i.e. from net selling price to value in use and vice versa);
- if recoverable amount was based on value in use: a change in the amount or timing of estimated future cash flows or in the discount rate;
- if recoverable amount was based on net selling price: a change in estimate of the components of net selling price.

The following pitfalls need to be considered when potentially reversing an impairment loss. If there is an indication that an impairment loss recognised for an asset no longer exists or has decreased, this may indicate that the remaining life, the depreciation (amortisation) method or the residual value need to be reviewed, even if no impairment loss is reversed for the asset (DAS 121.206). An asset's value in use may become higher than the asset's carrying amount simply because the current value of future cash inflows increases as they get closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time, even if the recoverable amount of the asset becomes higher than its carrying amount (DAS 121.607).

10.5.1 Reversing an impairment of an individual asset

The increased carrying amount of an asset due to a reversal of an impairment loss should not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior reporting periods (DAS 121.608). A reversal of an impairment loss for an asset should be recognised as income immediately in the profit and loss account, unless the asset is carried at a revalued amount. Any reversal of an impairment loss on a revalued asset should be treated as a revaluation increase in accordance with Article 2:390(1) NCC (DAS 121.610). A reversal of an impairment loss on a revalued asset is credited directly to equity under 'revaluation reserve'. However, to the extent that an impairment loss on the same revalued asset was previously recognised as an expense in the profit and loss account, a reversal of that impairment loss is recognised as income in the profit and loss account (DAS 121.611). After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset should be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life (DAS 121.612).

10.5.2 Reversing an impairment for a cash-generating unit

A reversal of an impairment loss for a cash-generating unit should be allocated to increase the carrying amount of the assets other than goodwill on a *pro rata* basis based on the carrying amount of each asset in the unit (DAS 121.613). These increases in carrying amounts should be treated as reversals of impairment losses for individual assets and recognised in accordance with paragraph 10.5.1. In allocating a reversal of an impairment loss for a cash-generating unit, the carrying amount of an asset should not be increased above:

- its recoverable amount (if determinable); and
- the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised in prior reporting periods.

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset should be allocated to the other assets of the unit on a *pro rata* basis (DAS 121.614). An impairment loss recognised for goodwill should not be reversed in a subsequent period (Article 2:387(5) NCC).

10.6 Compensation for impairment or loss of assets

An entity may receive monetary or non-monetary compensation from third parties for an impairment loss or the loss of an asset. Examples of such compensation are an insurance payment after a natural disaster or compensation after expropriation (DAS 121.701). An impairment loss on an asset or the loss of an asset, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets qualify as separate events. They are recognised as follows (DAS 121.702):

- impairments losses are recognised in accordance with the provisions of this chapter;
- monetary or non-monetary compensation from third parties for assets that were impaired or lost is included in determining profit or loss when the receipt of the compensation is probable; and
- the cost of assets restored, purchased or constructed as replacements is recognised as the acquisition cost of an asset.

An impairment loss should be recognised if the carrying amount of an asset is higher than its recoverable amount. Compensation to be received from third parties for the restoration of an impaired asset is not included in determining the recoverable amount of that asset (DAS 121.703).

10.7 Presentation and disclosure

For each class of assets, an entity's financial statements should disclose (DAS 121.801):

- the amount of impairment losses recognised in the profit and loss account and the items in which those impairment losses have been included;
- the amount of reversals of impairment losses recognised in the profit and loss account and the items in which those impairment losses have been included;
- the amount of impairment losses recognised directly in equity during the financial year; and
- the amount of reversals of impairment losses recognised directly in equity during the financial year.

A class of assets is a grouping of assets of similar nature and use in an entity's operations (DAS 121.802).

This required information may be presented with other information disclosed for the class of assets. For example, this information may be included in a movement schedule of the assets (DAS 121.803).

Large entities applying DAS 350 'Segment information' (see paragraph 30.6) are required to disclose the following for each reportable segment (DAS 121.804):

- the amount of impairment losses recognised in the profit and loss account and directly in equity during the financial year; and
- the amount of reversals of impairment losses recognised in the profit and loss account and directly in equity during the financial year.

If an impairment loss for an individual asset or a cash-generating unit is recognised or reversed during the financial year and is material to the financial statements of the entity as a whole, the entity should disclose (DAS 121.805):

- the main events and circumstances that led to the recognition or reversal of the impairment loss;
- the amount of the impairment loss recognised or reversed;
- for an individual asset:
  - the nature of the asset; and
  - the reportable segment to which the asset belongs;
- for a cash-generating unit:
  - a description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, a reportable segment);
  - the amount of the impairment loss recognised or reversed by class of assets and by reportable segment; and
  - if the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the recoverable amount, a description of the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified;
- whether the net selling price or value in use applies;
- if the recoverable amount is the net selling price: the basis used to determine the net selling price (e.g. by reference to an active market); and
- if the recoverable amount is the value in use: the discount rate(s) used in the current estimate and previous estimate (if any) of the value in use.

If impairment losses recognised (reversed) during the reporting period are material in aggregate to the financial statements of the entity as a whole, the entity should provide a brief description of the following (DAS 121.806):

- the main classes of assets affected by impairment losses (or reversals of impairment losses) for which no information is disclosed as described above; and
- the main events and circumstances that led to the recognition (or reversal) of these impairment losses for which no information is disclosed as described above.

An entity is encouraged to disclose key assumptions used to determine the recoverable amount during the financial year (DAS 121.807).

10.8 Exemptions for medium-sized and small entities

Medium-sized entities are exempt from:

- disclosing the segment information as discussed in paragraph 10.7 (DAS 121.804);
- making further disclosures about an impairment loss.

The second bullet point means that medium-sized entities do not have to make the following disclosures (DAS 121.805(c2) to (g)):

- for an individual asset, the reportable segment to which the individual asset belongs;
- for a cash-generating unit:
  - a description of the relevant cash-generating unit;
  - the amount of the impairment loss recognised or reversed by class of assets and by reportable segment;
  - if the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit’s recoverable amount: a description of the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified;
- whether the net selling price or value in use applies;
- if the recoverable amount is the net selling price: the basis used to determine the net selling price; and
- if the recoverable amount is the value in use, the discount rate(s) used in the current estimate and previous estimate of the value in use.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ("over and above the legal minimum") in the notes.

10.9 Significant differences from IFRS

Timing of impairment tests
IAS 36 ‘Impairment of assets’ requires an impairment test to be performed for intangible fixed assets if an indication of impairment exists. DAS 121 does the same. However, irrespective of whether there is any indication of impairment, IFRS requires an entity to test the following categories of intangible fixed assets for impairment every year:

- intangible fixed assets with an indefinite useful life;
- intangible fixed assets not yet available for use; and
- goodwill acquired in a business combination.

Irrespective of whether there is any indication of impairment, DAS 210.419 requires an entity to test the following categories of intangible fixed assets for impairment every year:

- intangible fixed assets not yet available for use; and
- intangible fixed assets amortised over a (total) economic life exceeding 20 years.

11 Inventories

11.1 Introduction

Inventories are defined as assets (DAS 220.0):

- held for sale in the ordinary course of business;
- in the production process for such sale; or
- in the form of raw materials or consumables to be consumed in the production process or in the rendering of services.

It depends on the function of the goods whether they should be classified as inventory or not. For example, goods held to be permanently used in the entity's own business must be classified as tangible fixed assets. The same holds true for the inventory of spare parts and spare equipment if the assets are used for more than one period. See also paragraph 7.2.1 on the recognition of tangible fixed assets. Generally, goods that are not intended to serve the entity's activity on a lasting basis are part of inventories. The recognition of construction contracts for third parties in the financial statements is discussed in Chapter 12.

11.2 Recognition in the balance sheet

General
Inventories must be recognised as assets only if (DAS 220.201):

- it is probable that the future economic benefits associated with the asset will flow to the entity; and
- the cost of the assets can be measured reliably.

Legal title versus beneficial ownership
Inventories do not include goods delivered to a third party under retention of title. The company does have legal title, but not beneficial ownership, to these goods and therefore they are not capitalised. The opposite is also true. Goods delivered to the entity under retention of title *are* capitalised because the entity holds the beneficial ownership of these goods. The price risk of goods placed in custody or sent on approval remains with the depositor, who must therefore include the goods in their balance sheet. The same goes for goods on consignment. The depositor continues to hold beneficial ownership and legal title and, as a result, they are also included in the depositor's balance sheet.

Technical versus economic inventories
'Technical' inventory is the inventory that is physically present (including inventories stored with third parties for the company). In addition to physically present inventories in warehouses, goods in transit may also be recognised as actual inventory. The determining factor here is the moment when all significant rights to economic benefits and all significant risks relating to the goods are transferred to the acquiring entity. The purchasing conditions (known as 'Incoterms') that the acquiring entity has agreed with the supplier often play an important role in this assessment.

Economic inventory is the inventory that is subject to price risk. In quantitative terms, the economic inventory consists of the technical inventory plus purchase contracts (including forward purchase contracts) less sales contracts (including forward sales contracts). The recognition of inventories on the basis of the economic inventory cannot be a basis for recognition and/or measurement in the balance sheet (DAS 220.204). To the extent that concluded pre-sales and/or pre-purchases of inventories at the reporting date indicate that a loss will result upon settlement, it must be determined whether these are onerous contracts (DAS 220.205). See paragraph 16.7.2.

Advance payments
Pursuant to Article 2:369 NCC, advance payments on inventories must be presented separately under inventories.

11.3 Measurement

The law requires inventories, other than agricultural inventories, to be measured at cost (purchase cost respectively manufacturing cost), as the Decree on current value provides that only agricultural inventories may be measured at current value (Article 8 of the Decree on current value). At the time of measurement, the inventories actually present must be included in the measurement. This means that the 'normal inventory' may not be taken as a basis, as occurs in certain current value systems, the iron inventory system ('ijzeren voorraadstelsel') and certain LIFO systems

(DAS 220.204). Similar inventories must be measured in the same way. However, it is possible to distinguish multiple groups of inventories within a company, for example if the function of the inventories differs for each segment.

11.3.1 Cost

Cost measurement must consist of the purchase cost or manufacturing cost and other costs incurred in bringing the inventories to their present location and condition (DAS 220.302). The purchase cost comprises the purchase price and additional costs (Article 2:388(1) NCC). Additional costs include import duties and other taxes (other than taxes the entity can recover from the Tax Administration), transport and handling costs and other costs that are directly attributable to the purchase of inventory. Trade discounts, rebates and other similar payments received or to be received in relation to the purchase are deducted from the purchase cost. These discounts also include payment discounts received if the company opts to make immediate or early payment to its suppliers.

Example: Allocation of transport costs

Company A operates several clothing shops under a particular retail format. Eighty shops across the country are stocked from three large distribution centres. It is common for shops to then supply stock to each other in connection with customer orders. May these transport costs between shops be considered part of the purchase cost of inventories?

As a rule, costs incurred for bringing inventory to the right location can be allocated to cost (DAS 220.302). Allocating costs for transport from the distribution centre to the shops is therefore permitted. However, the transfer of stock from one shop to another in connection with purchase orders does not involve costs that are attributable to the purchase process itself. These transport costs are more similar in nature to selling costs (necessary to complete the sales transaction). After completing the purchase process, A may not allocate any further costs to the inventory measurement.

Example: Allocation of conditional discounts

Company B has concluded a purchase contract with a supplier that includes a volume discount. If more than 1,000 products are purchased over the period 1 July of year 1 - 30 June of year 2, a different price tier applies and a retrospective discount is granted on those 1,000 products already purchased in that period. Based on purchasing needs, it is considered probable that the volume threshold of 1,000 will be met. This estimate is unchanged at the reporting date (31 December of year 1) and the date of preparation of the financial statements for year 1.

This situation means that part of the purchase cost is variable - a mirror image compared to the situation described in DAS 270 of variable consideration included in the transaction price of a sale. Prudence should also be exercised in this purchasing situation to ensure that the purchase cost of the inventory is not measured too low and the cost of sales has to be increased at a later stage. It is probable that the discount will be obtained in this case, so it is taken into account in the measurement of the inventory. Therefore, when the invoices of the first 1,000 products are recognised, an accrued asset will be recognised for the purchase discount expected. The cost of goods sold in the period and the measurement of inventory not sold as at the reporting date are set at the purchase price less the discount.

Measurement at car and motorcycle importers, dealers and other car companies engaged in selling motor vehicles subject to passenger car and motorcycle tax must be exclusive of this tax (DAS 220.303). See paragraph 26.8.2.

The manufacturing cost must include the direct costs of manufacturing and may also comprise a reasonable proportion of indirect costs and attributable borrowing costs (Article 2:388(2) NCC). Where costs are involved in bringing the inventories to their present location (transport) or condition (processing), they are allocated to inventories to the extent that the costs are directly related to those inventories. This covers all costs involved, i.e. indirect production costs in addition to direct costs. Indirect production costs must be allocated (see 'Production costs' below). Indirect - general - overhead costs may not be allocated (see 'Other costs' below). This effectively means that the Dutch Accounting Standards Board has restricted the option given by law in Article 2:388(2) NCC.

Production costs
The allocation of production costs to manufacturing cost must be systematic and consistent (DAS 220.305). The production costs of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable indirect production costs that are incurred in converting raw

materials and consumables into finished products. Fixed indirect production costs are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management. Variable indirect production costs are costs that vary directly, or nearly directly, with the volume of production, such as indirect raw materials and consumables and indirect labour (DAS 220.306).

The allocation of fixed indirect production costs to manufacturing cost is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The allocation of fixed indirect production costs to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised in the profit and loss account in the period in which they are incurred. In periods of abnormally high production, the allocation of fixed production costs to each unit of production is decreased so that inventories are not measured above cost. Variable production costs are allocated to each unit of production on the basis of the actual use of the production facilities (DAS 220.307).

A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the production costs of each product are not separately identifiable, they are allocated between the products on a reasonable and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net selling price and this price is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost (DAS 220.308).

Example: Direct costing

A production company applies direct costing (DC) in its internal accounting records to determine the cost of its finished product. DC is a costing method in which only variable costs are allocated to the finished product. Can the company also use this method for its financial statements?

This direct costing method is not an acceptable basis for measuring the inventory of finished product in the financial statements, as the fixed and variable indirect production costs resulting from the conversion of raw materials and consumables into finished product must be allocated to manufacturing cost in a systematic way.

Other costs
If overhead costs, other than production costs, or client-specific design costs have been incurred in bringing inventories to their present location and condition, they are included in the cost of inventories (DAS 220.309). However, costs that cannot be part of the cost of inventories include (DAS 220.310):

- abnormal amounts of wasted raw materials and consumables, labour or other production costs;
- storage costs, unless these costs are necessary for a subsequent production process or processing operation or are necessary because a longer period of time is needed to make the inventories suitable for sale (e.g. Cognac ageing);
- administrative overheads that do not contribute to bringing inventories to their present location and condition; and
- selling costs.

Borrowing costs
If payment of the cost of inventories is based on a longer than normal payment period, the cost of the inventories must be based on the present value of the liability (DAS 220.311). The manufacturing cost of inventories may include the attributable interest on debt over the period of manufacturing (Article 2:388(2) NCC). If inventories have not been manufactured but, for example, purchased, interest cannot be included in the cost of the inventories. This cost is then referred to as 'purchase cost' rather than manufacturing cost. See Chapter 27 for a more detailed explanation and the conditions attached to capitalising interest in the manufacturing cost of inventories.

Example: Deferred payment

A dealership buys 10 tractors (part of its trading inventory) on its own account, for which it only has to pay after two years. The invoice value of the tractors totals 933,120. Had the company paid within 30 days, it would have had to pay 800,000 to the supplier. The effective interest rate charged by the supplier is 8%. How should the deferred payment be included in the cost of the inventories?

The payment period is considerably longer than normal. The supplier actually not only supplies tractors but also provides a financial product (a two-year loan).

The dealership measures its inventories at 800,000 with a corresponding loan (under non-current debt) of 800,000. The loan accrues interest at a rate of 8%, making the loan 864,000 after one year (64,000 to be recognised as borrowing costs). After two years, the loan amounts to 933,120 (= 864,000 * 1.08), after which it is repaid.

Foreign currency and basis adjustment
If inventories are paid in foreign currency, the standard translation rules of DAS 122 'Measurement bases for foreign currency' (see Chapter 4) apply. On the date of initial measurement, translation into the functional currency must take place at the spot exchange rate prevailing on that date. Because the subsequent measurement is at historical cost (apart from any agricultural inventories; see below), no further adjustment is made if exchange rates change after initial measurement.

However, a special situation arises if the (probable) purchase of the inventory in foreign currency is considered a hedged item in a cash flow hedge transaction. Such hedging may take place by means of a forward foreign exchange contract that allows the company to exchange a fixed number of functional currencies for a fixed number of foreign currencies needed to pay for the inventories. If the company's measurement basis is that the forward contracts are measured at fair value, the effective portion of the change in value of the forward contract is recorded directly in equity (cash flow hedge reserve/revaluation reserve) to avoid mismatches. DAS 290 states that when the inventories are delivered, the cash flow hedge reserve is transferred and incorporated into the initial measurement of the inventory. Assuming that the hedge is effective, the inventory is then measured at the forward rate in functional currency. This adjustment to the initial measurement of the inventory is known as 'basis adjustment'. See paragraph 21.7.4.2; see the annex to Chapter 21 for an example.

Incidentally, cost hedge accounting may also be applied. In that case, the forward foreign exchange contract is measured at cost (usually nil) and the inventory is also determined at the number of functional currencies to be sold (forward rate), assuming that an effective hedge is in place. See paragraph 21.7.4.3; the annex to Chapter 21 also contains an example of this.

Minimum measurement rule
Inventories measured at purchase cost or manufacturing cost (including any capitalised indirect costs and capitalised interest) must be measured at net selling price if it is lower than cost on the reporting date (DAS 220.322). This provision is in line with the legal provision that current assets are measured at current value if it is lower than the purchase cost or manufacturing cost on the reporting date (Article 2:387(2) NCC). The net selling price can be used as the lower current value and is the maximum amount at which an asset can be sold, less costs yet to be incurred (Article 5 of the Decree on current value). The write-down is charged to profit or loss. For raw materials and consumables, it must be established that based on the net selling price of the finished product, the net selling price of the raw materials and consumables to be derived from it is at least equal to the carrying amount (DAS 220.327).

Example: Write-down to the lower net selling price

A car dealer has two outdated (obsolete) types in stock, with the following specifics:

- Type 1. Carrying amount of 10,000 each. Normal selling price: 15,000. This type is still available at a purchase cost of 5,000. The dealer still expects to sell type 1 if it is priced down to 7,500. The costs still to be incurred after the sale (transport, installation) are estimated at 1,000.

- Type 2. Carrying amount of 10,000 each. Normal selling price: 15,000. This type is no longer available and the dealer does not expect to be able to sell this type anymore. A buyer is willing to take the stocks without compensation.

Type 1 will have to be written down to the lower net selling price. The net selling price is 6,500 (= 7,500 - 1,000), which means that the write-down is 3,500 (= 10,000 - 6,500). If the inventories are sold as expected, no profits or losses are recognised on the transaction at a later date. If a write-down to the lower purchase cost of 5,000 had taken place, 5,000 (= 10,000 - 5,000) would have been written down in the financial year. Then, following a sale, a profit of 1,500 (= 7,500 - 5,000 - 1,000) would be recognised. Such a write-down would be too prudent and is not in line with the idea behind the recoverable amount.

For type 2, the net selling price is nil and the carrying amount of 10,000 will be written down.

Short-term foreseeable impairment losses
Recognition of impairment losses that are foreseeable shortly after the reporting date is not permitted, as impairment losses that are foreseeable shortly after the reporting date do not relate to the situation on the reporting date.

However, impairment losses that occur after the reporting date and are material must be disclosed (Article 2:380a NCC). Furthermore, this may need to be addressed in the management board report. We refer to the provisions on subsequent events in paragraph 2.7.

11.3.2 Agricultural inventories at current value

Agricultural inventories are the harvested products of living animals or plants (DAS 220.0). Only agricultural inventories may be measured at current value pursuant to Article 8 of the Decree on current value. Where agricultural inventories are measured at current value, the net selling price qualifies (Article 8 of the Decree on current value). The net selling price is the maximum amount at which an asset can be sold, less costs yet to be incurred (Article 5 of the Decree on current value). If the entity has concluded (forward) contracts for the sale of inventories present at the reporting date, the net selling price is derived from these contracts. If not, the net selling price is derived from the market quotation as at the reporting date (DAS 220.329).

Changes in the value of agricultural inventories measured at current value must be recognised in the period in which the change in value occurs (DAS 220.406).

Agricultural inventories should not be confused with 'biological assets'. Biological assets (living animals or plants) are held because of their ability to transform, such as multiplication, growth, harvesting and degeneration. Examples include livestock and parcels of woodland, i.e. living animals and plants. Agricultural inventories, by contrast, consist of harvested (finished) agricultural produce. Harvesting is the detachment of produce or the cessation of the life processes of a living animal or plant. With agricultural inventories, the transformation process is complete and marketing can take place. Agricultural inventories include not only agricultural inventories produced by the company itself, but also purchased agricultural inventories. This means that, for example, a dealer in agricultural products can measure its purchased inventories at current value.

Changes in value recognised directly in profit or loss
Changes in the value of agricultural inventories for which frequent market quotations exist can be recognised immediately in profit or loss (Article 2:384(7) NCC). The change in value may be recognised as part of (DAS 220.405):

- change in inventories of finished product and work in progress (Model E of the Decree on annual accounts format); or
- cost of sales (Model F of the Decree on annual accounts format). If an entity recognises the changes in value immediately in profit or loss, no revaluation reserve is recognised pursuant to Article 2:390(1) NCC.

The law does not define 'frequent market quotations'. The Explanatory Memorandum to bill 29 737 does provide clues as to what the legislator intended by the notion of 'frequent market quotations'. The relevant Explanatory Memorandum refers to 'readily observable developments in liquid markets' and to 'profits or losses from current assets that can be readily sold at prevailing market prices at any time'. The law does not define the term 'liquid market', either. The Explanatory Memorandum to the Decree on current value notes that IAS 38 lists some conditions for a liquid market in the context of measuring an intangible fixed asset (Article 6 of the Decree on current value). These conditions are: the relevant assets are homogeneous, buyers and sellers can be found regularly and transaction prices are publicly known. We stress that these conditions are not explicitly mentioned in the context of frequent market quotations.

Changes in value recognised directly in equity
Increases in the value of agricultural inventories for which no frequent market quotations exist are recognised directly in equity. Changes in the value of agricultural inventories for which frequent market quotations do exist can also be recognised directly in equity (Article 2:384(7) NCC). If increases in the value of agricultural inventories are recognised directly in equity (regardless of whether they are inventories for which frequent market quotations exist or not), they are recognised in a revaluation reserve (Article 2:390(1) NCC).

The revaluation reserve is determined as the difference between the value of inventories at current value and their value at cost. Impairment losses are first charged to the revaluation reserve. Impairment losses exceeding previous additions to the revaluation reserve are charged to the profit and loss account.

The revaluation reserve does not exceed the difference between the carrying amount based on purchase cost or manufacturing cost and the carrying amount based on current value. On sale, the revaluation is realised and therefore the revaluation reserve is reduced (Article 2:390(3) NCC). The revaluation realised must be recognised in a separate item in the profit and loss account (DAS 220.404). Otherwise, these amounts would never be recognised in the profit and loss account.

11.3.3 Weighted average prices, FIFO and LIFO

Measurement rules such as weighted average prices, FIFO ('First In First Out'; the inventory present consists of the last purchases), LIFO ('Last In First Out'; the inventory present consists of the first purchases) or similar rules can be applied for comparable components (Article 2:385(2) NCC).
However, this must be done consistently, i.e. for all inventories of a similar nature and/or use according to consistent practice. The application of different cost methods may be justified for inventories that differ in nature and/or use. In this context, LIFO refers to both individual LIFO (per transaction) and collective LIFO. Under collective LIFO, the inventory at the end of the reporting period is compared with the inventory at the start of the reporting period. If the quantity of goods present at the end of the reporting period is larger than at the beginning of the year, the excess is measured at the oldest purchase prices of the period. The expansion of the inventory has effectively created a new LIFO band. If the quantity of goods is subsequently reduced, the newest bands are deemed to have been absorbed first in the cost of sales.

The difference between measurement according to a weighted average price system, FIFO and LIFO can be illustrated as follows.

	Weighted average prices		FIFO		LIFO	
	Quantity	Price per piece	Quantity	Price per piece	Quantity	Price per piece
Inventory at the beginning of the financial year	100	9.00	100	12.00	100	5.00
Purchases	100	14.00	100	14.00	100	14.00
Sales	80		80		80	
Inventory at the end of the financial year	120	11.50	120	13.67	120	6.50
Calculation of inventory measurement		(= (100 x 9) + (100 x 14)) / 200		(= (100 x 14) (20 x 12)) / 120		(= (100 x 5) + (20 x 14)) / 120

This overview shows that application of LIFO without further explanation does not provide sufficient insight in equity. The application of LIFO results in inventories being measured at relatively old prices based on the assumption that prices will rise. Also, if inventories are reduced, the profit or loss will be higher than based on the applicable cost in that period. That is why the Dutch Accounting Standards Board recommends the application of FIFO and weighted average prices (DAS 220.316). Incidentally, this recommendation is not included in the DASsmall bundle and, as a result, does not apply to small entities.

Parts of the inventory that are collectively of minor importance, regularly replaced and of fairly fixed composition and quantity may be included at a fixed quantity and value (Article 2:385(3) NCC).

11.3.4 Inventories arising from intercompany transactions

Profits on intercompany transactions between group companies must be eliminated if and to the extent that they have not yet been realised through delivery to third parties outside the group. See Chapter 15 for more details.

11.4 Presentation and disclosure

Inventories are the first category of current assets. The following items are shown separately under inventories (Article 2:369 NCC):

- raw materials and consumables;
- work in progress;
- finished product and goods for resale;
- advance payments on inventories.

Other categories can also be distinguished for special branches of industry.

The release of the revaluation reserve of agricultural inventories measured at current value is presented as a separate item in the profit and loss account (DAS 220.504). In our opinion, it would be logical to add this item to net margin in the profit and loss account (under the model by function) or to deduct it from operating expenses (under the model by nature of expense). This differs from the presentation of the release of other revaluation reserves credited to profit or loss as prescribed in DAS 240.411 (see paragraph 14.3.7.11).

The following information must be included in the notes (DAS 220.601):

- the accounting policies applied for the measurement of the different inventories and for determining profit or loss on goods transactions and positions, including, in the case of measurement at cost, a statement of the application of one of the rules such as FIFO, weighted average prices or LIFO;
- an explanation of how the net selling price is determined;
- the carrying amount of inventories measured at the lower net selling price;
- the cost of inventories recognised as an expense in the profit and loss account;
- the amount of write-down and loss of inventories in the profit and loss account;
- the amount of the reversal of the write-down of inventories recognised in the profit and loss account;
- the circumstances or events that led to the reversal of a write-down; and
- the carrying amount of inventories pledged as security for liabilities.

If inventories are measured according to LIFO, the following information must be included in addition to DAS 220.601 (DAS 220.602):

- how LIFO is applied (on an accrual or per-period basis); and
- the inventory measurement if it were based on cost according to FIFO or weighted average prices to the extent that this leads to significant differences in equity.

Where agricultural inventories are measured at current value, the following information must be included in the notes in addition to DAS 220.601 (DAS 220.603):

- an explanation of how the net selling price is determined;
- the amount of the revaluation of inventories credited to and/or the write-down of inventories charged to the revaluation reserve;
- the amount of value changes recognised directly in the profit and loss account; and
- whether and how the impact of taxes has been taken into account in connection with the revaluation.

If interest has been allocated to the manufacturing cost of inventories, the following must be disclosed (DAS 220.604):

- the fact that interest on debt has been included in the measurement of inventories; and
- the amount of interest capitalised in the inventories during the reporting period.

If obligations to buy or sell inventories are of particular significance, the amount and term of these obligations must be disclosed (DAS 220.605). When applying the model by nature of expense of the profit and loss account, the composition of the cost of sales recognised in the profit and loss account must be disclosed (DAS 220.606). Cost of sales includes raw materials and consumables, wages and social security charges and other attributable operating expenses and the amount of the net change in inventories in the relevant period.

11.5 Exemptions for medium-sized and small entities

Pursuant to Article 2:397(3) NCC, medium-sized entities are exempt from disclosing the cost of inventories recognised in the profit and loss account (DAS 220.601) and from disclosing the composition of cost of sales when applying the model by nature of expense of the profit and loss account (DAS 220.606).

Pursuant to Article 2:396 NCC, small entities are exempt from the further breakdown of inventories (Article 2:369 NCC).

The recommendation not to apply LIFO does not apply to small entities.

Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the legal minimum') in the notes.

11.6 Significant differences from IFRS

Current value
IAS 2 'Inventories' allows measurement at net selling price ('net realisable value') for inventories of producers of agricultural or mineral products. Furthermore, under IAS 2 brokers/dealers can measure their inventories at fair value less selling costs. In both cases, changes in value are recognised as a profit or loss in the period of a change in value. Under NL GAAP, only agricultural inventories may be measured at current value. Where agricultural inventories are measured at current value, the net selling price qualifies (Article 8 of the Decree on current value). The net selling price is the maximum amount at which an asset can be sold, less costs yet to be incurred (Article 5 of the Decree on current value).

LIFO
Unlike the law and DAS 220 'Inventories', IAS 2 does not permit application of LIFO. DAS 220.317 does recommend not applying LIFO.

12 Construction contracts

12.1 Introduction

General

Construction contracts ("construction contracts") are contracts that have been agreed with a third party and that relate to the construction of an asset or a combination of assets. The execution of such contracts usually extends over more than one reporting period (DAS 221.0). DAS 221 does not apply to inventories (DAS 221.103). Work in progress recognised under inventories according to Article 2:369 NCC does not include construction contracts. Semi-finished products are an example of work in progress and are therefore presented under inventories. See Chapter 11 for the treatment of inventories. Revenue from the sale of inventories is recognised if the requirements included in DAS 270.110 are met (see Chapter 26). This is usually only the case when the inventory is delivered to the buyer. By contrast, revenue from construction contracts is recognised by reference to the stage of completion of the work.

Examples of construction contracts include the construction of a single asset, such as a bridge, building, dam, pipeline, road, ship, tunnel or custom software. Construction contracts may also deal with the construction of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use; examples of such contracts include the construction of complex plants (such as refineries), equipment and systems. The following contracts are also considered construction contracts within the meaning of DAS 221 (DAS 221.106):

- contracts for the rendering of services which are directly related to the construction of the asset (for example, contracts for the services of project managers and architects);
- contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets;
- contracts for the development of assets for third parties where the assets do not create an alternative use for the entity.

Application of IFRS 15 'Revenue from Contracts with Customers'

The pre-existing facility (option) in the standards to apply IFRS 15 'Revenue from Contracts with Customers' instead of DAS 270 and DAS 221 for the reporting of revenues and related expenses remains. This means that entities that want to stay as close as possible to the IFRS frameworks in their company-only financial statements under Title 9 Book 2 NCC (e.g. because IFRS must also be applied for consolidation purposes for the benefit of the ultimate parent entity) can continue to choose this option, but only if they apply IFRS 15 consistently and in full. If the entity uses this option, the application of IFRS 15 replaces the application of the provisions of DAS 270 relating to the sale of goods and the rendering of services and the provisions of DAS 221 relating to construction contracts (DAS 221.102a).

Fixed-price and cost-plus contracts

Construction contracts can be distinguished according to the nature of the contracts on which they are based, i.e. (DAS 221.0 and 221.107):

- fixed-price contracts: the contract is performed at a fixed price and may include price clauses, to be further subdivided as follows:
    - contracts stipulating a fixed price for all of the work;
    - contracts stipulating a fixed price for units of output within the work as a whole (known as the 'bill of quantity' system);
- cost-plus contracts: the contract is performed on the basis of reimbursement of all or certain defined costs, plus a certain percentage or a fixed amount.

Contracts may differ in terms of the nature of the risks borne by the contractor. In general, fixed-price contracts, stipulating a fixed fee for all of the work, carry the highest risk for the contractor.

Property development

DAS 221 contains specific provisions for property development. See paragraph 12.6 for a discussion of property development.

Rendering of services
The provisions relating to the recognition of contract revenues and contract costs applicable to construction contracts generally also apply to the recognition of service revenues and costs (DAS 221.102). Revenues are recognised in the period in which the services are rendered if the conditions regarding recognition of profit in proportion to the work performed as defined in DAS 270 are met. The recognition of revenues and costs of construction contracts is detailed in paragraph 12.5.

12.2 Combining and segmenting construction contracts

The provisions of DAS 221 are usually applied to each individual contract that qualifies as a construction contract. However, in certain circumstances, it is necessary to apply DAS 221 to a group of contracts in order to reflect the economic reality of a group of contracts (DAS 221.110).

The criteria for recognising contract revenues and contract costs are applied to the totality of related contracts. This is required if these contracts are so related that they cannot be properly understood without considering them in context.

According to DAS 115.107, financial statements must reflect the economic reality of transactions. For example, a company may have concluded multiple separate contracts. These contracts may have been negotiated as a single project, where the individual contracts are closely related in terms of pricing and profit margin and they are executed simultaneously or immediately after each other. Contracts may also be related if there are multiple customers (DAS 221.110).

12.3 Identifying performance obligations

Contract revenue recognition criteria are usually applied to each individual contract. However, in certain circumstances, these criteria are applied to the separately identifiable performance obligations of a contract in order to reflect economic reality. This means the company must determine whether the goods or services promised in a contract are separate performance obligations.

A performance obligation is defined as a commitment in a contract to deliver (DAS 221.112):

- a distinct good or service or a combination of goods or services that are collectively distinct from other commitments in the contract; or
- a series of distinct services that are largely the same.

A performance obligation must be identified separately if the following criteria are met (DAS 221.112):

a. the customer can independently benefit from the goods or services, on its own or together with resources that the customer has or can obtain; and
b. the promise to transfer the goods or services is distinct from the other promises included in the contract.

The following circumstances indicate that two or more promises by the entity to provide goods or services included in a contract are not separately identifiable (DAS 221.112):

- the entity provides a significant service of integration of the goods or services with other goods or services promised in the contract, where those goods or services collectively constitute the promise for which the customer has contracted. In other words, the entity uses the goods or services as a means to deliver the combined goods and/or combined services to the customer. An example is the construction of an office building on the customer's instructions;
- one or more of the goods or services significantly modify other goods or services promised in the contract;
- the goods or services are highly dependent on, or closely related to, other goods or services promised in the contract, such as the development of a prototype on a customer's instructions. The design and production of the prototype are closely related.

Needless to say, some situations require a high degree of judgement to identify separate performance obligations.

The following is an example of a situation where separate performance obligations have been identified, resulting in the recognition of revenue for each separate performance obligation:

Example: Purchase/construction contracts (based on Example 1e from Appendix 1 to DAS 270)

A construction company concludes a purchase/construction contract for a detached house with a customer. Under this contract, a piece of land is sold and an instruction is received to build a detached house. The transfer of ownership of the land will take place at the time of signing the deed of transfer. The actual transfer of the house will follow on completion when the construction of the house is finished. Two promises can be identified in this case:

- the transfer of ownership of the land; and
- the construction of the house (construction work).

It must be determined whether the construction work agreed is a separate performance obligation in addition to the transfer of ownership of the land. To this end, it must be assessed whether (DAS 221.112):

1. the customer can independently benefit from the land transferred and the construction work, whether or not jointly with resources the customer has or can obtain; and
2. the commitment to deliver the land is distinct from the promised construction work.

The condition under 1 is met because the customer could independently benefit from the land transferred by, for example, engaging another party to carry out construction work. This must therefore be assessed separately from the contractual restrictions. In addition, the customer can also benefit from the construction work in conjunction with the land transferred.

For the purpose of the condition under 2, it must be assessed whether:

a. the entity provides a significant service of integration between the two promises;
b. the construction work significantly alters the land transferred; and/or
c. the land transferred is highly dependent on, or closely related to, the construction work.

The aforementioned situations do not apply. The goods and services to be provided by the entity in respect of the commitment to carry out construction work are the same regardless of whether the entity transfers the land or not. Furthermore, while there is a functional relationship between the land to be transferred and the construction work to be performed, this does not mean that the entity is providing a significant service of integration as referred to in DAS 270.109. The risks the entity assumes when transferring the land to the customer are separable from the risks the entity assumes in the construction work to be carried out.

There are two separate performance obligations (the transfer of the land and the performance of construction work). The total transaction price is allocated in proportion to the value of the performance obligations to both separate performance obligations (see paragraph 26.5) and revenues are recognised for each separate performance obligation. The portion of the transaction price allocated to the construction work is recognised as revenue by reference to the stage of completion of the construction work (in line with DAS 221 'Construction contracts'). The portion of the transaction price allocated to the transfer of the land is recognised as revenue when the conditions set out in DAS 270.110 on the sale of goods are met.

12.4 Contract revenues and contract costs

12.4.1 Contract revenues

General
Contract revenues are revenues arising from and directly attributable to a construction contract (DAS 221.0).
Contract revenues arising from a contract consist of (DAS 221.201):

- contractually agreed revenues; and
- revenues based on reduced work, claims and allowances, if and to the extent:
    - it is probable that the revenues will be realised; and

- the revenues can be reliably determined.

An entity recognises revenues for the amount it expects to be entitled to in exchange for the goods and services provided. This amount is referred to as the transaction price; it does not include amounts collected on behalf of third parties. The transaction price may be fixed consideration, variable consideration or a combination of both. Credit risk is not taken into account when setting the transaction price. Any write-downs resulting from credit risk are recognised as costs in the profit and loss account. In determining the transaction price, the entity assumes that the goods or services will be provided in accordance with the relevant contract and that this contract will not be cancelled, extended or otherwise modified. Non-monetary consideration must be measured at fair value (DAS 221.202).

Variable consideration
The transaction price may vary due to rebates, refunds, repayments, price concessions, performance bonuses, penalties or other similar components. The transaction price may also vary if the entity's right to the consideration depends on the occurrence or non-occurrence of a future event. Such consideration is referred to as 'variable consideration'.

To determine the transaction price, an entity must estimate the amount of the variable consideration while exercising prudence. The aim of exercising prudence is to ensure that only revenues are recognised that are unlikely to have to be reversed later.

The uncertainty with regard to estimating the amount of variable consideration may be so high that the outcome of a construction contract cannot be reliably determined. See paragraph 12.5.3 for the situation where the estimation uncertainty is so high that the outcome of a construction contract cannot be reliably determined.

The estimated amount of variable consideration must be updated at the end of each reporting period (DAS 221.202a).

Significant financing component
The receipt of consideration for the completion of a construction contract may have been deferred without an interest payment having been agreed. In such a situation, a financing component will usually be included in the consideration. The fair value of the revenue to be recognised then consists of the present value of the consideration. Alternatively, a company may have received pre-financing from a customer. In both situations, the transaction price is adjusted for the effects of the time value of money if a contract contains a significant financing component. A contract may contain a significant financing component if the construction contract is completed earlier or later than payment of the consideration. If a significant financing component exists, the time value of money is recognised separately as interest in the profit and loss account (income or expense). Consequently, this applies to both financing provided and financing received. For the construction contract itself, revenue is recognised by reference to the stage of completion, based on the selling price excluding the interest surcharge. This selling price is the present value of the total consideration as paid (either in advance or in arrears, possibly in instalments).

Whether a financing component is significant depends on its relative size. In any case, a financing component may be considered insignificant if, at the time of entering into a contract, the entity expects the financing period (i.e. the period between the time of completion and the time of payment) to be no more than one year.

An interest rate must be applied to calculate the present value. The interest rate must be set at (DAS 221.202b):

- the prevailing interest rate for a similar instrument of an issuer with a similar credit rating; or
- the interest rate that corresponds to the interest rate that discounts the transaction price to the current cash selling price of the goods or services.

The difference between the face value and the fair value is recognised as interest income or an interest expense in the usual manner in the period between the creation of the receivable and the expected receipt (i.e. by means of amortisation using the effective interest method).

Contract amendments, including additional and reduced work
An amendment to a contract creates new enforceable rights and obligations of the parties to a contract or modifies existing rights and obligations. An amendment may be created in writing or verbally, or it may be implicit from customary business practices. Additional and reduced work are an example of a contract amendment. Additional and reduced work are instructions from the customer to change the scope of work compared to the contractually agreed

performance. Additional and reduced work may lead to an increase or a decrease in contract revenues. Examples of additional and reduced work include changes in the specifications or design of the asset and changes in the term of the contract.

Additional work
For additional work, the entity determines whether or not the additional work constitutes a separate performance obligation in relation to the construction contract in progress. The following situations may arise (DAS 221.205):

- the additional work is not a separate performance obligation in relation to the construction contract in progress. In this situation, the additional work is recognised as a change to the construction contract in progress. The effect of the change on the transaction price and on the measurement of the stage of completion made with complete fulfilment of the performance obligation of the construction contract is recognised as an adjustment (increase or decrease) to cumulative revenues at the time of the change. This is also known as 'cumulative catch-up';
- the additional work is a separate performance obligation in relation to the construction contract in progress and the consideration agreed reflects the value of the additional work. The additional work is then recognised as a separate contract;
- the additional work is a separate performance obligation in relation to the construction contract in progress, but the consideration agreed does not reflect the value of the additional work. In this case, the additional work is not recognised as a separate contract. The modified transaction price is then allocated to the original performance obligation and to the additional work. The change in the transaction price allocated to the construction contract in progress (the original performance obligation) results in an adjustment (increase or decrease) to cumulative revenues at the time of the change. The additional work is recognised as a separate performance obligation in relation to the construction contract in progress. Revenues and costs resulting from additional work are recognised in accordance with paragraph 12.5 'Recognition of contract revenues and contract costs' based on the transaction price allocated to the upward contract variations.

In practice, additional work will often not be a separate performance obligation due to integration with, modification of or relationship with the other commitments (see paragraph 12.3).

Reduced work
Any reduced work agreed are recognised as a change to the current contract in progress. The effect of the reduced work on the transaction price and on the stage of completion of the construction contract is recognised as an adjustment to the cumulative revenues (increase or decrease) when the reduced work is agreed (i.e. cumulative catch-up) (DAS 221.205).

Example: Change resulting in cumulative catch-up (based on Example 8 of IFRS 15)

Construction company B concludes a contract for the construction of a commercial building for a customer at a contract price of 1 million and a bonus of 200,000 if the building is delivered within 24 months. B recognises the bundle of goods and services promised in the contract as a single performance obligation of which the contract revenues and contract costs are recognised in the profit and loss account by reference to the stage of completion of as at the reporting date.

At the start of the contract, B expects the contract profit to be 300,000 (= 1,000,000 in contract revenues - 700,000 in contract costs). At the start of the contract, B excludes the bonus of 200,000 from the transaction price because it cannot conclude that it is unlikely that the revenue from the bonus has to be reversed later. After all, only revenues that are unlikely to have to be reversed later may be recognised. The completion of the building is highly subject to factors beyond B's control, such as the weather and legal approvals. Moreover, B has only limited experience with similar types of contracts.

B determines the stage of completion based on the contract costs incurred up to the reporting date in relation to the estimated total contract costs. At the end of year 1, the work is 60% ready based on the costs incurred to date of 420,000 against the total expected cost of 700,000. B reassesses the variable consideration and concludes that the amount still cannot be included in the transaction price. As a result, cumulative revenues recognised in year 1 are 600,000 (= 60% x 1,000,000). The cumulative contract profit at the end of year 1 is therefore 180,000 (= 600,000 - 420,000).

At the beginning of year 2, the parties agree to amend the contract by changing the floor plan of the building. As a result, the contract price and expected costs increase by 150,000 and 120,000, respectively. The total potential consideration after the amendment is 1,350,000 (contract price of 1,150,000 + completion bonus of 200,000). Moreover, the time allowed for achieving the bonus is extended by six months to 30 months from the original contract start date. On the date of the amendment, B concludes - based on its experience and the remaining work to be carried out, which is mainly within the building and not subject to weather conditions - that it is highly probable that the bonus will be achieved. This means that there is only a small chance that including the bonus in the transaction price will lead to a subsequent reversal of the revenue. Therefore, B includes the bonus of 200,000 in the transaction price.

In assessing the contract amendment, B evaluates that the remaining goods and services to be provided under the amended contract are no different from those transferred on or before the contract amendment date, i.e. the contract remains a single performance obligation.

As a result, B recognises the additional work as an amendment to the construction contract in progress. The effect of the change in the transaction price and the degree of progress is recognised by means of a cumulative catch-up of revenues as at the date of the contract amendment. The progress rate is now set at 51.2% (= 420,000 in actual costs incurred / 820,000 in total expected costs). The cumulative contract revenues are then 691,200 (= 51.2% x 1,350,000). At the end of year 1, cumulative contract revenues were 600,000. This means that, on the amendment date, additional revenues of 91,200 (= 691,200 - 600,000) are recorded as a cumulative catch-up.

Claims
A claim is an amount that the company wants to claim from the customer or another party as compensation for costs incurred that are not specified in the contract. A claim may arise from delays caused by the customer, errors in specifications or design, and disputed reduced work. The estimation of revenues from claims is often uncertain for a long time and their amount often depends on negotiations. Claims are only recognised in contract revenue if (DAS 221.204):

- it is probable that the customer will accept the claim; and
- the amount of the claim that will probably be accepted by the customer can be reliably determined.

Consideration payable to customers
Sometimes an entity pays amounts to a customer, for example to compensate the customer for investments the customer has to make to construct an asset. A company recognises a payment to be made to customers as a reduction in the transaction price and therefore as a reduction in contract revenue, unless the payment to the customer is made in exchange for a distinct good or service. The consideration payable to the customer includes the amounts the company pays or expects to pay to the customer, as well as other components (e.g. a coupon or voucher) that may be deducted from amounts the customer owes the entity (DAS 221.203).

12.4.2 Contract costs

General
Contract costs are costs attributable to a construction contract based on the entity's contract activities or on contractual terms (DAS 221.0). The contract costs of a contract consist of (DAS 221.206):

- costs directly related to the contract;
- costs attributable to contract activities in general and allocable to the contract; and
- other costs contractually attributable to the customer.

Costs to obtain the contract
Contract costs include attributable costs from the date the contract is obtained to the final completion of the contract. Costs directly related to a contract and incurred in obtaining the contract are part of the contract costs if (DAS 221.207):

- it is probable that the contract will be obtained;
- these costs can be separately identified; and
- can be reliably determined.

Costs incurred for obtaining a contract may be recognised in the profit and loss account in the period in which they are incurred. In that case, they are not included in the contract costs if the contract is obtained in a subsequent period.

Direct costs
Costs directly related to the contract may include (DAS 221.208):

- labour costs for employees working directly on the contract, including supervision costs;
- costs of materials used in construction;
- costs of land and sites and of contributing them;
- depreciation of plant and equipment used on the contract;
- costs of moving plant, equipment and materials to and from the contract site;
- costs of hiring plant and equipment;
- costs of design and technical assistance that are directly related to the contract;
- the estimated costs of rectification and guarantee work, including expected warranty costs; and
- claims from third parties.

Incidental income obtained by a company that is not part of contract revenue is deducted from the contract costs (DAS 221.209), For example income from the sale of surplus materials and a profit on the disposal of plant and equipment at the end of the contract.

Indirect costs
Costs attributable to contract activities in general and allocable to the contract may include (DAS 221.210):

- insurance;
- costs of design and technical assistance that are not directly related to a specific contract; and
- overhead costs of contract activities.

Such attributable costs with similar characteristics are systematically and consistently allocated to construction contracts. The allocation is based on the normal level of contract activities. The normal level of contract activities is the average activity expected to be achieved under normal circumstances over a number of periods or seasons, taking into account the loss of capacity resulting from planned maintenance (DAS 221.211). Overhead costs of contract activities include costs for preparing and recognising contract and payroll records. See Chapter 27 for the possible attribution of interest to contract costs. Other costs contractually attributable to the customer are administrative expenses and development costs for which reimbursement is agreed in the terms of the contract (DAS 221.212).

The following costs are not classified as contract costs if they are not attributable to contracts or allocable to contract activities (DAS 221.213):

- general administrative expenses;
- selling costs;
- research and development costs for which no reimbursement has been agreed; and
- costs of depreciation of plant and equipment that are not used for the contract or for contract activities.

12.5 Recognition of contract revenue and contract costs

12.5.1 General

The recognition of contract revenue and contract costs depends on whether the outcome of a construction contract can be reliably estimated. If that is the case, a company recognises the contract revenue and contract costs by reference of the stage of completion as at the reporting date (DAS 221.301). This is the percentage of completion method. If this is not the case, the zero profit method is applied.

In both methods, an entity recognises losses expected on the construction contract immediately as an expense in the profit and loss account.

Revenue recognition provisions are applied to each individual performance obligation of a construction contract. By contrast, the provisions on losses expected on construction contracts are applied to the total of all performance obligations in a contract (DAS 221.301), which constitutes an onerous contract. See paragraph 12.5.6.

Specific conditions for fixed-price and cost-plus contracts
With regard to a construction contract, the following conditions must be met to establish that the outcome of a construction contract can be reliably estimated (DAS 221.302):

- total contract revenues can be reliably determined;
- it is probable that the economic benefits associated with the construction contract will flow to the company;
- both the contract costs required to complete the construction contract and the stage of completion of the construction contract at the reporting date can be reliably determined; and
- the contract costs attributable to the construction contract can be clearly distinguished and reliably determined so that the actual costs spent can be compared with pre-calculations or prior estimates.

With regard to a cost-plus contract, the following conditions must be met to establish that the outcome of a construction contract can be reliably estimated (DAS 221.303):

- it is probable that the economic benefits associated with the construction contract will flow to the company; and
- the contract costs attributable to the construction contract, whether or not recoverable under the contract, can be clearly and reliably determined.

12.5.2 Percentage of completion method

The method of recognising revenues and costs by reference to the stage of completion is also known as the 'percentage of completion' method. In this method, contract revenues and contract costs are allocated to the period such that the revenues and costs are recognised in the profit and loss account by reference to the stage of completion. This method provides insight into the extent of the goods and services provided and their financial impact during a period (DAS 221.304).

The percentage of completion method results in recognition of contract revenues in the profit and loss account in the periods in which the work is performed. Contract costs are usually recognised in the profit and loss account in the period in which the contract to which they relate is performed. If the total contract costs of a construction contract are expected to exceed total contract revenues, the expected loss is recognised immediately in the profit and loss account (DAS 221.305).

The outcome of a construction contract can only be reliably estimated if it is probable that the economic benefits associated with the contract will flow to the company. However, if it has subsequently become uncertain whether contract revenue previously recognised in the profit and loss account is collectible, the uncollectible amount or the amount about which uncertainty has arisen is recognised as an expense in the profit and loss account rather than as a change in previously recognised contract revenues (DAS 221.306).

In principle, a company is able to make reliable estimates if the contract agreed includes the following aspects (DAS 221.307):

- each party's enforceable rights regarding the services to be provided, including the asset to be constructed;
- the consideration for the goods and services provided; and
- the manner and terms of settlement.

The company also assesses whether the requirements set for the reliability of the determination of the contract costs are met. If the consideration for the goods and services provided is fully or partly variable, the degree of uncertainty about the extent of variable consideration is included in the assessment of whether the total contract revenues can be reliably determined, as part of the assessment of whether the outcome of a construction contract can be reliably determined.

The uncertainty with regard to estimating the amount of variable consideration may be so high that the amount of the total contract revenues and the outcome of a construction contract cannot be reliably determined. If a contract consists of fixed and variable consideration, the amount of the fixed consideration may be so high that the amount of the total contract revenues can be reliably determined despite the uncertainty about the amount of the variable consideration.

An entity reviews the estimates of contract revenues and contract costs as the work progresses and revises the amounts when necessary. Revisions to estimates do not necessarily indicate that the outcome of the contract cannot be reliably estimated (DAS 221.308).

Determination of the stage of completion
The stage of completion of a construction contract may be determined in a variety of ways. An entity chooses the method that reliably determines the stage of completion of the construction contract. Depending on the nature of the contract, the methods may include (DAS 221.309):

- the contract costs incurred up to the reporting date in proportion to the estimated total contract costs;
- inspection of the performed part of the work; or
- completion of a physically distinct contract component.

The above methods can be applied by measurements of completed contract parts, by the completion of a physically distinct contract part, by indicators mentioned in the contract (phase A, phase B, etc.), by the number of man-hours spent or a combination of methods, and the like. In some cases the contract explicitly includes formal measurement moments, for example based on the indicators mentioned above, with the customer accepting the contract part up to that point. A company then runs virtually no risk on the phase of the work preceding the measurement moment. In the absence of such formal measurement moments, the company is responsible for the work performed during the entire term of the contract until the contract is completed in full. However, this does not mean that recognising revenues and costs in the profit and loss account is impossible (DAS 221.310).

Payments in proportion to the progress made on the contract and advance payments or progress payments made by customers are not necessarily representative of the stage of completion (DAS 221.311). Expenditures related to contract costs that lead to goods and services to be provided after the reporting date are recognised as assets if it is probable that they will lead to revenues in a subsequent period. Such capitalised expenditures represent an amount ultimately recoverable from the customer or recouped through sale and are often recognised as inventories (DAS 221.312).

If the stage of completion is determined in proportion to the contract costs incurred to date, only those contract costs that reflect the goods and services provided are recognised in the profit and loss account. Contract costs that are not, or not yet, recognised in the profit and loss account are, for example (DAS 221.313):

- expenditures related to goods and services yet to be provided under the contract, such as costs of materials delivered that have not yet been installed, used or applied during contract performance, unless the materials have been made specifically for that contract; and
- advance payments for subcontracted work, including the work of subcontractors.

By their nature, the aforementioned expenditures and advance payments are mostly recognised in inventories.

Changes in accounting estimates
The method of recognising contract revenues and contract costs by reference to the stage of completion is applied cumulatively in each successive period, using current estimates of contract revenues and contract costs. Changes in accounting estimates relating to contract revenues or contract costs or to the outcome of a contract are recognised in accordance with DAS 145 'Changes in accounting estimates' (see paragraph 3.2). This means that changes in accounting estimates are recognised prospectively. In fact, the changed accounting estimates are used to determine revenues and costs to be recognised in the profit and loss account in the period in which the estimate was changed and in subsequent periods (DAS 221.322).

Example: Percentage of completion

A bridge builder entered into a contract with a fixed contract price of 9,000 to build a bridge. The costs associated with this contract were initially estimated at 8,000. The construction period is three years.
At the end of year 1, the contract cost estimate was revised to 8,050.

In year 2, the customer accepts an adjustment in the contract which results in an increase in the contract price of 200 and an increase in estimated costs of 150. This adjustment is not a separate performance obligation. Therefore, this adjustment is recognised as a change in the construction contract in progress. At the end of year 2, the costs recognised to date include 100 for standard materials stored in the warehouse that will be used in year 3 to complete the work.

The bridge builder determines the percentage of completion based on the percentage of costs incurred in relation to the most recent estimate of total expected costs.

	Year 1	Year 2	Year 3
Contract costs incurred at the end of each year	2,093	6,168	8,200
Total estimated contract costs	8,050	8,200	8,200

The question is what the percentage of completion at the end of each year is and what the annual revenues and costs and the annual profit will be.

	Year 1	Year 2	Year 3
Initially agreed contract price	9,000	9,000	9,000
Contract price adjustment	-	200	200
Total contract price	9,000	9,200	9,200
Costs already incurred	2,093	6,168	8,200
Costs to be incurred	5,957	2,032	-
Total estimated contract costs	8,050	8,200	8,200
Estimated total contract profit	950	1,000	1,000
Percentage of completion*	26%	74%	100%
Cumulative profit	247	740	1,000

* The percentage of completion for year 2 (74%) is determined by eliminating the costs incurred of 100, regarding standard materials to be used in year 3, from the costs already incurred for year 2 (= (6,168 - 100) / 8,200).

The amounts of revenues, costs and profit to be recognised in the profit and loss account are then as follows:

	Cumulative	Recognised in previous years	Recognised in the current year
Year 1			
Revenues			2,340
Costs			2,093
Profit			247
Year 2			
Revenues	6,808	2,340	4,468
Costs	6,068	2,093	3,975
Profit	740	247	493
Year 3			
Revenues	9,200	6,808	2,392
Costs	8,200	6,068	2,132
Profit	1,000	740	260

12.5.3 Zero profit method

If the outcome of a construction contract cannot be estimated reliably (DAS 221.314):

- revenues must only be recognised in the profit and loss account up to the amount of contract costs incurred that will probably be recoverable; and
- the contract costs must be recognised in the profit and loss account in the period in which they are incurred.

The above method of recognition is also known as the 'zero profit' method. The difference with the completed contract method is that revenues are recognised even during the term of the contract. This means that the completed contract method cannot be applied.

In the early stages of a construction contract, it may not always be possible to reliably estimate the outcome of the construction contract. However, it is often probable that the entity will be able to recover the contract costs already incurred. In this case, revenues are only recognised in the profit and loss account up to the amount of contract costs that will probably be recoverable from the customer. If the outcome of the construction contract cannot be reliably estimated, no profit is attributed. The aim here is to ensure that only revenues are recognised that are unlikely to have to be reversed later.

Even if the outcome of a construction contract cannot be reliably estimated during the performance of the work, it may turn out that the total contract costs exceed the total contract revenues. As with the percentage of completion method, the expected losses are then immediately recognised as an expense in the profit and loss account (see paragraph 12.4.6).

If the outcome of the construction contract cannot be reliably estimated and it is not probable that the contract costs incurred to date can be recovered, no revenues are recognised. The contract costs incurred are recognised in the profit and loss account. If it is probable that part of the contract costs incurred to date can be recovered by revenues, revenues are recognised to the extent that it is probable that the costs can be recovered (DAS 221.315).

Series of short-term contracts
There may be a flow of contracts. For practical reasons, it is permitted to recognise contract revenues and contract costs according to DAS 221.314 ('zero profit' method), even if the outcome of the contracts can be reliably determined. This recognition is possible if (DAS 221.316):

- the terms of the contracts are mostly shorter than 12 months; or
- there is a steady flow of contracts of stable size, whose completion shows a pattern of regular distribution.

Recognising revenues up to the amount of the contract costs incurred during the term of the contract ('zero profit' method) is only permitted if it does not have a material impact on the company's equity and profit or loss (DAS 221.316).

12.5.4 Disappearance of uncertainties regarding estimates

If there are no longer any significant uncertainties regarding the ability to reliably estimate the outcome of a construction contract, contract revenues and contract costs must be recognised by reference of the stage of completion using the percentage of completion method rather than the zero profit method. This means that cumulative contract revenues are recognised prospectively in the profit and loss account based on the stage of completion at the time the uncertainties no longer exist (DAS 221.317).

12.5.5 Obligations after completion

A company may have obligations after the completion of a contract, including warranty obligations that have not been recognised as a separate performance obligation. If so, the company determines whether a provision must be formed in accordance with DAS 252 (DAS 221.318). See Chapter 16 for the recognition of provisions.

12.5.6 Recognition of losses on construction contracts

If it is probable, for all performance obligations in a contract, that the total contract costs will exceed the total contract revenues, a provision for an onerous contract must be recognised. As a result, the provision must be recognised at the level of the entire contract rather than at the level of the individual performance obligations within that contract. The size of the provision must be determined in accordance with the provisions for onerous contracts as described in paragraph 16.7.2. This means that a provision must be recognised if the unavoidable costs of meeting the contractual obligations exceed the benefits expected from the contract. The unavoidable costs of an onerous contract are the minimum costs that have to be incurred to dispose of the contract, i.e. the lower of the costs of meeting the obligations and the compensation or penalties incurred for failing to meet the obligations. The contract costs described in paragraph 12.4.2 are an interpretation of the costs of meeting the obligations of a contract (DAS 221.323).

If a loss on a construction contract is expected, it is presented as part of construction contracts in the balance sheet. This also applies to already identified losses on contracts for which no goods or services have yet been provided (DAS 221.412). Losses on construction contracts are recognised as part of costs in the profit and loss account.

Example: Recognition of expected losses

X took on a contract for 15,000. Halfway through the work, the contract costs are 10,000. The contract costs yet to be incurred are also calculated at 10,000. A total loss of 5,000 is therefore expected on the contract. The customer has not paid anything yet.

Contract revenues 15,000 * 50%		7,500
Costs of work performed	10,000	
Loss on work yet to be performed	2,500	
Total contract costs		12,500
Contract loss		(5,000)

In the balance sheet, the construction contract is measured at 5,000 (7,500 in revenues minus 2,500 in expected loss on work yet to be performed, also calculated as 10,000 in costs minus 5,000 in total expected loss).

The amount of this loss must be determined regardless of (DAS 221.324):

- whether or not the work has commenced;
- the stage of completion of the work; or
- the amount of profit expected on other, unrelated contracts.

Example: Determining the size of expected losses

X took on a contract for 19,500. The work consists of two phases. The estimated costs can be specified as follows:

	Phase I	Phase II
Direct labour costs	5,000	4,000
Direct machine costs	3,000	2,000
Indirect manufacturing costs	2,000	2,000
Surcharge for general administrative expenses	500	400
	10,500	8,400

The general administrative expenses are not attributable to contract activities in general and are not allocable to the contract. Phase I is completed at year-end. The progress made with the work is determined by an inspection of the performed part of the work. On this basis, contract revenues amount to 10,500. At the end of the year, the actual costs of phase I excluding the surcharge for general administrative expenses turn out to be 10,500. The customer has not paid anything yet.

How should the construction contract be recognised in the balance sheet?

It must be determined whether the contract as a whole is expected to be loss-making. This requires a determination of the estimated contract costs of phase II. These turn out to be 9,500 excluding the surcharge for general administrative expenses. Only general administrative expenses that are attributable to contract activities in general and that can be allocated to the contract are part of the contract costs (DAS 221.206).

The total contract costs of the contract excluding general management expenses are:

Actual costs of phase I	10,500
Estimated costs of phase II	9,500
Estimated total costs	20,000

As a result, there is a foreseeable loss on the contract as a whole of 500.

In the balance sheet, the construction contract is measured at 10,000 (= 10,500 in recognised contract revenues minus 500 in expected loss on the contract).

12.6 Property development

General

DAS 221 includes specific provisions for the recognition of property development revenues and costs. The question here is to what extent the accounting rules of construction contracts apply to property development activities. Property development is defined as the development and construction of an asset or assets for sale in ordinary operations that usually extends over more than one reporting period (DAS 221.0).

This means that property development refers to activities for long-term projects, for example for the construction of houses, offices and shopping centres. Residential development usually involves building plans initiated and to be developed by a company. Property development does not initially take place for customers, as property development is initiated by the company itself. In these projects, potential buyers can choose from units to be developed that are shown by means of drawings, such as flats or houses. Changes in the construction or composition of the units to be constructed are usually limited. Construction usually starts if and when a significant proportion of the units to be constructed have been contracted for sale. Customers are contractually bound to acquire units from the property development (e.g. a flat or a house).

According to the Dutch Accounting Standards Board, property development is to be equated with construction contracts in terms of its nature, risk and execution, if and to the extent that unconditional sales contracts have been concluded with customers for the assets resulting from the property development. In this situation, therefore, revenues and costs are recognised in accordance with the provisions on construction contracts as described in this chapter (DAS 221.108).

An entity may have placed property development and construction activities in separate entities within its group. See Chapter 15 for the recognition of transactions within a group and with group entities and/or associates.

Allocating contract revenues and contract costs
For the units sold unconditionally, the attributable portion of revenues and costs is classified as contract revenues and contract costs. In accordance with DAS 221.301 (DAS 221.319), the property developer recognises the contract revenues and contract costs in the profit and loss account by reference to the stage of completion. This means applying the percentage of completion method if profit or loss can be reliably estimated in the interim. The attributable portion of property development recognised in the profit and loss account by reference to the stage of completion is based on the total expected revenues and costs of the units sold (DAS 221.319).

If no unconditional sales contract has yet been concluded for contract units, the costs associated with these units are capitalised as inventories (DAS 221.321). The costs to be capitalised represent the attributable portion of the total contract costs incurred and related to future goods and services to be provided in subsequent periods. Such assets are measured according to DAS 220 on inventories (DAS 221.320). Once an unconditional sales contract is concluded for additional units during the performance of the work, the capitalised costs attributable to these units are also classified as contract costs and recognised in the profit and loss account by reference to the stage of completion (DAS 221.321).

Example: Property development

Entity PO bought a piece of cultivated land for 100 in the past. The zoning plan is amended after eight years, allowing PO to build a block of 10 flats. The buyers have no influence on the construction of the block of flats. Construction will start in year 1 and is expected to be completed in year 3 by transferring the flat rights to the buyers. The cultivated land was prepared for building by a third party in year 1, the cost of which was 400.

The construction cost per flat is expected to be 150. By the end of year 1, construction costs of 800 have already been incurred. This is in line with the expected costs and the costs can be divided proportionally among all ten flats. In year 2, costs of 500 are incurred; these costs exceed the expected costs by 50. The costs incurred in year 2 can also be divided proportionally among all ten flats. In year 3, construction of the block of flats is completed. The contract costs in that year are 250. The total contract costs are therefore 2,050, of which 1,550 are construction costs and 500 are land costs.

The selling price per flat is 300. Sales contracts for three flats were signed in year 1. It is expected that in year 2 the remaining flats will be sold at the stated selling price. In year 2, sales contracts were signed for six flats, resulting in one flat not being sold at the end of year 2. The expected sale proceeds at the end of year 2 for the last flat are 230. The last flat is sold in year 3 at a price of 240.

The total contract revenues expected at the end of year 1 are 3,000 (= 10 x 300). The total contract costs expected are 2,000 (= 1,500 + 500). A sales contract must be concluded with a third party to recognise the contract revenues. An important principle is that the attributable portion of property development recognised in the profit and loss account by reference to the stage of completion must be based on the total expected revenues and costs of units sold (DAS 221.319). This could be, for example, in proportion to the expected revenues and costs of the project as a whole. This means, therefore, that attribution cannot simply be based on the number of flats sold in relation to the total number of flats. This is possible only if the expected price of all flats is approximately the same. The progress made with the work in this example is determined by relating the contract costs incurred up to the reporting date to the estimated total contract costs.

The percentage completed and the percentage sold are determined at the end of each year as follows:

	Percentage completed	Percentage sold
End of year 1	65% (= 1,300 / 2,000)	30% (= 900 / 3,000)
End of year 2	88% (= 1,800 / 2,050)	92% (= 2,700 / 2,930)
End of year 3	100% (= 2,050 / 2,050)	100% (= 2,940 / 2,940)

The contract revenues to be recognised are determined as follows:

Contract revenues in year 1	585	(= 30% x 65% x 3,000)
Contract revenues in year 2	1,787	(= (92% x 88% x 2,930) - 585)
Contract revenues in year 3	568	(= 9 x 300 + 240 - 585 - 1,787)
Total contract revenues	2,940	(= 9 x 300 + 240)

The contract costs to be recognised are determined as follows:

Contract costs in year 1	390	(= 30% x 1,300)
Contract costs in year 2	1,266	(= (92% x 1,800) - 390)
Contract costs in year 3	394	(= 2,050 - 1,266 - 390)
Total contract costs	2,050	

The presentation of the profit and loss account according to model by nature of expense is then as follows:

	Year 1	Year 2	Year 3	Total
Net revenue	585	1,787	568	2,940
Contract costs	390	1,266	394	2,050
Profit	195	521	174	890
Margin	33%	29%	31%	30%

12.7 Presentation in the profit and loss account

General
A company can choose from two models for presentation in the profit and loss account:

- the model by nature of expense; and
- the model by function.

In general, application of the model by nature of expense will be easier. In both models, realised contract revenues are presented as part of net revenue in the profit and loss account (DAS 221.401). When applying the model by nature of expense, contract costs are presented in the profit and loss account according to their nature (DAS 221.403). When applying the model by function, contract costs are presented in the profit and loss account according to their function (DAS 221.405). Contract costs are usually classified as cost of sales.

Example: Presentation in the profit and loss account

A project was started during year 1 and will be completed in year 3. The revenue is 3,000. The total cost is 2,650. The percentage of completion is determined based on the percentage of costs incurred in relation to the most recent estimate of total expected costs. The project was completed for 19.25% at the end of year 1 and for 90% at the end of year 2. The costs in years 1 to 3 are as follows:

	Year 1	Year 2	Year 3	Total
Raw materials	100	500	50	650
Labour costs	200	800	100	1,100
Depreciation	100	200	50	350
Other construction costs	110	375	65	550
	510	1,875	265	2,650

The profit in year 1 is (rounded) 68 (= (19.25% of 3,000) - (19.25% of 2,650)). The presentation in the profit and loss account is as follows:

Model by nature of expense - POC:

		Year 1		Year 2		Year 3		Total
Net revenue		578		2,122		300		3,000
Raw materials	100		500		50		650	
Labour costs	200		800		100		1,100	
Depreciation	100		200		50		350	
Other construction costs	110		375		65		550	
		510		1,875		265		2,650
Profit		68		247		35		350

Model by nature of expense - zero profit method:

		Year 1		Year 2		Year 3		Total
Net revenue		510		1,875		615		3,000
Raw materials	100		500		50		650	
Labour costs	200		800		100		1,100	
Depreciation	100		200		50		350	
Other construction costs	110		375		65		550	
		510		1,875		265		2,650
Profit		-		-		350		350

Model by function - POC:

	Year 1	Year 2	Year 3	Total
Net revenue	578	2,122	300	3,000
Cost of sales	510	1,875	265	2,650
Gross margin	68	247	35	350

Model by function - zero profit method:

	Year 1	Year 2	Year 3	Total
Net revenue	510	1,875	615	3,000
Cost of sales	510	1,875	265	2,650
Gross margin	-	-	350	350

Example: Presentation of a construction contract with pre-calculated loss

A project has a duration of three years and was taken on at the outset with a pre-calculated loss, but thanks to efficient work and a stringent procurement policy, it was eventually closed with a profit.

The pre-calculation and actual profits are shown below:

	Pre-calculation
Labour costs	3,000
Raw materials	6,000
Other attributable costs to the project	1,000
Contract cost	10,000
Tender price (revenue)	9,500
Pre-calculated loss	500

	Actual Year 1	Actual Year 2	Actual Year 3	Actual Total
Labour costs	1,000	750	750	2,500
Raw materials	2,000	1,750	1,750	5,500
Other attributable costs	350	275	275	900
Contract cost	3,350	2,775	2,775	8,900
Progress invoices sent	2,500	3,500	3,500	9,500

As a result of taking on a project with a pre-calculated loss of 500, a provision is made for this loss immediately in the first year (the actual loss in year 1 corresponds to the pre-calculation). At the end of year 2, it becomes clear that the contract will end not with a loss, but with a profit of 600. In year 2, the loss from year 1 is reversed.

Recognition in the balance sheet:

	End of year 1	End of year 2	End of year 3
Costs spent	3,350	6,125	-
Less: provision for construction contracts	500	-	-
	2,850	6,125	-
Less: progress invoices sent	2,500	6,000	-
	350	125	-
Add: recognition of interim profit	-	300	-
Balance sheet as at 31 December	350	425	-

Recognition of the actual profits and losses in the profit and loss account according to the model by nature of expense is then as follows (the progress invoices sent do not affect the presentation in the profit and loss account):

		Year 1		Year 2		Year 3		Total
Net revenue		3,350		3,075		3,075		9,500
Labour costs	1,000		750		750		2,500	
Raw materials	2,000		1,750		1,750		5,500	
Movement in loss provision	500		-500					
Other attributable costs	350		275		275		900	
		3,850		2,275		2,775		8,900
Profit/(Loss)		(500)		800		300		600

12.8 Presentation in the balance sheet

General

Construction contracts are presented in a separate item in the balance sheet. Under Article 7(2) of the Decree on annual accounts format, an item may be inserted to the extent that its contents are not covered by other items in the balance sheet (DAS 221.406). The construction contracts item consists of, where applicable, the balance of realised contract costs, attributed profit, recognised losses and progress invoices sent. The construction contracts item represents an amount due from the customer (if an asset), or an amount due to the customer (if a liability) for work yet to be performed or an amount received in advance. Progress invoices sent are therefore not separately recognised as a liability item in the balance sheet.

Construction contracts are not part of inventories in the balance sheet. Inventories are recognised in the balance sheet as an asset. Proceeds from the sale of inventories are not recognised in the profit and loss account until the moment of sale as a result of delivery. The balance sheet item 'construction contracts' represents the net selling price of goods and services already provided during the performance of the contract that have already been recognised in the profit and loss account. The balance sheet item 'construction contracts' actually represent an amount receivable from customers (if the value of the work performed exceeds the progress invoices sent) or an amount payable to customers (if the amount of the progress invoices sent exceeds the value of the work performed) (DAS 221.407). As contract revenue and contract costs have been recognised in the profit and loss account by reference to the stage of completion, the balance determined for construction contracts cannot be presented as inventories. Article 2:388(2) NCC does not allow attributed profit on construction contracts to be part of the manufacturing cost for the measurement of inventories (DAS 221.408).

Netting by project

The entity presents a construction contract in the balance sheet as a netted item of contract revenues realised per project, less recognised losses and progress invoices sent. Progress invoices sent are not recognised in the balance sheet until the entity or customer has fulfilled their obligations at the reporting date (DAS 115.113).

The balance of construction contracts as at the reporting date may be a debit or credit balance, depending on the amount of realised contract costs and attributed profit, recognised losses and progress invoices already sent. If the balance of the construction contract is a debit, the company presents the net amount as an asset. In case of a credit balance, the company recognises the net amount as a liability (DAS 221.409).

Separate balance sheet item 'construction contracts'
A debit balance in construction contracts is presented separately in the balance sheet under current assets between inventories and receivables (DAS 221.409). Construction contracts with a credit balance are presented separately in the balance sheet under current debt (DAS 221.409).

Example: Presentation of construction contracts in the balance sheet

A company has two construction projects for third parties (contract A for party A and contract B for party B). For contract A, the realised contract costs and attributed profit amount to 200 and the progress invoices sent amount to 100. For contract B, the realised contract costs and attributed profit amount to 100 and progress invoices sent amount to 150. The presentation according to DAS 221.409 results in the recognition of an asset item amounting to 100 (for contract A) and a liability amounting to 50 (for contract B).

Expenditures for which no goods or services have yet been provided
A company may incur expenditures on contracts where no goods or services have been provided yet. The company recognises these expenditures as an asset, usually as part of inventories (raw materials, work in progress or advance payments on inventories). An example would be materials brought on a construction site that have not yet been used. If these capitalised expenditures are presented as part of construction contracts, the amount is disclosed in the notes (DAS 221.411). These contract costs are recognised in the profit and loss account once the goods and services under the contract are delivered and provided.

Presentation of loss-making contracts
If a loss on a construction contract is expected, it is presented as part of the construction contracts item in the balance sheet (DAS 221.412). This also applies to already identified losses on contracts for which no goods or services have yet been provided, as a negative measurement of a construction contract represents an amount due to the customer.

Property development
In property development where work on a contract has already started but the project has not yet been fully sold, a split must be made in the balance sheet. The unsold part of the contract is 'work in progress inventory'. As no sales contracts have yet been agreed with third parties, this is the company's own inventory. After all, the company holds this inventory for its own account and risk. Where sales contracts have been concluded with third parties, these are construction contracts. As a consequence, revenues will be recognised for the sold part based on the progress made with the work. In the balance sheet, the cross-entry of these revenues is recognised under the construction contracts item. At the time of invoicing, the accounts receivable item is increased. The cross-entry is deducted from the construction contracts item.

Example: Presentation of property development in the balance sheet

See the details of PO of the example in paragraph 12.5. The movements in expenditures (land and construction costs) and attributed profit are as follows:

	Year 1	Year 2	Year 3	Total
Land costs	500	-	-	500
Construction costs	800	500	250	1,550
Total expenditures	1,300	500	250	2,050
Invoices sent	500	1,700	740	2,940
Amounts received	300	1,400	1,240	2,940
Contract revenues recognised	585	1,787	568	2,940
Contract costs recognised	390	1,266	394	2,050

In the balance sheet, the costs spent for the unsold part of the contract are presented as inventory (for own account and risk). Construction contracts presents the recognised contract revenues (for the sold part). Progress invoices sent are deducted from the construction contracts item. The construction contracts item actually concerns a receivable from customers who have already concluded a contract with PO, but for which progress invoices have not yet been sent. Invoicing leads to the recognition of receivables. The presentation in the balance sheet is as follows:

	End of year 1		End of year 2		End of year 3
Work in progress inventory	910	(= 1,300 - 390)	144	(= 910 + 500 - 1,266)	-
Construction contracts	85	(= 585 - 500)	172	(= 85 + 1,787 - 1,700)	-
Accounts receivable	200	(= 500 - 300)	500	(= 200 + 1,700 - 1,400)	-
Bank	300		1,700		2,940
Total in the balance sheet for the contract	1,495		2,516		2,940

12.9 Disclosure

The following information is disclosed in the financial statements (DAS 221.414):

- revenues from construction contracts recognised in the profit and loss account in the period;
- the method used to recognise contract revenues in the profit and loss account; and
- the method used to determine stage of completion when performing the construction contracts.

In particular, the identification of performance obligations will require a high degree of judgement in some situations (see paragraph 12.3). Similarly, the recognition of contract revenue will often involve estimates of total contract costs and possible uncertainties related to additional revenues, variable considerations, claims or other elements (see paragraph 12.5). Although not specifically addressed in DAS 221.4, such judgments and estimates regarding the recognition of construction contracts, to the extent that they have a significant impact on the amounts included in the financial statements, should be disclosed on the basis of the insight requirement. For example, DAS 110.129 stipulates in a general sense and by means of a firm statement that if it is necessary to provide the legally required insight, the entity must disclose the nature of these judgments and estimates, including the associated assumptions.

We also point out the disclosure requirements in DAS 270.6 that relate to the profit and loss account and in particular revenue. DAS 270.601 requires disclosure of the nature of the significant performance obligations and the method of allocating revenue for each significant performance obligation. In our opinion, these provisions also apply if important performance obligations are distinguished in the context of DAS 221 'Construction contracts'. This is also in line with the firm statement in DAS 221.112 which stipulates that the entity must recognise revenue per separate performance obligation. This can be particularly important if a construction contract consists of multiple performance obligations.

Regarding construction contracts at the reporting date, a company discloses (DAS 221.415):

- the cumulative total of contract revenues recognised to date;
- the total of the progress invoices sent;
- the amount of capitalised expenditures on goods and services not yet provided if and to the extent that they are presented as part of construction contracts; and
- in the situation where a company has been formally given notice of default, the total of the amounts withheld by the customers from the progress payments.

Amounts are withheld by customers when progress invoices sent are not paid because certain contractual conditions have not yet been met or shortcomings have not yet been resolved (DAS 221.416).

The total capitalised costs of acquiring a contract included in the construction contracts item must be disclosed (DAS 221.418).

A company discloses contingent income and expenses related to construction contracts. Contingent income also includes consideration not yet recognised as revenue due to the inability to reliably determine the amount of the revenue (DAS 221.419).

12.10 Transitional provisions

A change in accounting principles as a result of the amendments to DAS 221 from 1 January 2022 - or the relevant effective date in case of earlier application - constitutes a change in accounting policies. In principle, a change in accounting policies must be recognised retrospectively, including adjustment of the comparative figures (DAS 140).

To simplify implementation, the DASB has adopted transitional provisions. A choice may be made to recognise the changes related to the *recognition and measurement* of construction contracts (DAS 221.602):

- prospectively. The amended standards will then only have to be applied to contracts entered into or amended on or after 1 January 2022, or the relevant effective date in case of earlier application. The old standards still apply to contracts entered into or amended on an earlier date;
- partially retrospectively. It is also permitted to apply the changes only to contracts entered into or amended on or after an earlier date chosen by the entity itself, which must be before 1 January 2022, or the relevant effective date in case of earlier application; or
- fully retrospectively.

The notes must explain how the transition is recognised. They must also indicate how the old and new accounting policies differ and that the change in the standards is the reason for the change in accounting policies (Article 2:384(6) NCC). In addition, the disclosure requirements of DAS 140 'Changes in accounting policies' apply in case of fully and partially retrospective recognition. This effectively means that in case of fully or partially retrospective recognition, the adjustments in the comparative figures must also be disclosed (in accordance with Article 2:384(6) NCC).

Changes relating to *presentation and disclosure* may not be recognised prospectively. These changes then do require the comparative figures to be adjusted, and the adjustments to be disclosed (Article 2:363(4) NCC).

12.11 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.
Small entities are subject to standards based on those for large and medium-sized entities as described in this chapter, albeit with a few significant differences.

The principal difference is that small entities can choose between applying the percentage of completion method or the zero profit method, regardless of whether the criteria for applying the percentage of completion method are met (DASsmall B5.308). However, the same method must be applied to similar contracts.

In addition, small entities are not required to present construction contracts in a separate balance sheet item (DASsmall B5.322). If no separate item is included, construction contracts are part of receivables and, if applicable, current debt.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

12.12 Significant differences from IFRS

IFRS 15 'Revenue from Contracts with Customers'
Under IFRS, IFRS 15 'Revenue from Contracts with Customers' has applied since 2018. IFRS 15 has replaced both IAS 11 'Construction Contracts' and IAS 18 'Revenue', including the interpretations related to these standards. The Dutch Accounting Standards Board has decided to maintain the current chapter structure in which revenue recognition rules are dealt with in both DAS 270 'The profit and loss account' and DAS 221 'Construction contracts'. See paragraph 26.13 for general differences between IFRS 15 and the Dutch Accounting Standards.

Property development
IFRS 15 contains general criteria for determining whether performance obligations in contracts arising from property development are fulfilled at a specific point in time or during a period. The entity must recognise revenues at a specific point in time if the entity fulfils a performance obligation at one specific point in time. The entity fulfils a performance obligation during a period and must recognise revenues during that period if one of the following conditions is met:

a. the customer simultaneously receives and consumes the benefits from the entity's performance as the entity performs (e.g. providing cleaning services at the customer's premises);
b. the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced (e.g. performing work on the customer's property); or

c. the entity's performance creates an asset with no alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. At all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date (including the profit margin) if a contract is terminated by the customer for reasons other than the entity's failure to perform as promised. In this respect, the entity takes into account the terms of the contract and relevant legislation.

DAS 221 defines a construction contract as a contract agreed with a third party and that relates to the construction of an asset or a combination of assets where the execution usually extends over more than one reporting period. Subsequently, if the profit or loss of a construction contract can be reliably estimated, the contract revenues and contract costs related to the construction contract should be recognised as revenue and expenses in profit or loss in proportion to the work performed at the balance sheet date. Therefore, the above criteria set out in IFRS 15 are not mentioned in DAS 221.

13 Other current assets

13.1 Introduction

General
In addition to inventory and construction contracts, current assets may include other items. These items are receivables, securities, prepayments and accrued income as well as cash. These items are included in current assets only if they are not held for long-term support of the entity's operations (Article 2:364(1) NCC). If these items are held for long-term support of the entity's operations, they classify as fixed assets. The distinction between fixed and current assets aims to provide insight into a company's liquidity position. See paragraph 2.11 for a more detailed explanation of the classification as fixed or current assets.

Receivables
Receivables are the rights existing as at the reporting date to receive cash from other parties (DAS 222.0). Examples of receivables include accounts receivable, receivables from loans and claims for compensation (DAS 222.101).

Securities
Securities is the collective term for papers representing value such as shares, depository receipts, claims, bonds, options, futures, warrants and entries in debt and share registers (DAS 226.0). See paragraph 2.11 regarding the classification of securities as fixed or current assets.

Prepayments and accrued income
Current assets also separately include prepayments and accrued income, to the extent they are not presented under receivables (Article 2:364(3) NCC). Examples of prepayments and accrued income are amounts paid in advance for expenses chargeable to future periods or amounts receivable in respect of income recognised in favour of previous periods (DAS 224.102).

Cash
Cash consists of cash in hand, balances in bank and giro accounts as well as bills of exchange and cheques (Article 2:372(1) NCC). If cash is not (expected to be) available to the entity for more than 12 months, it is classified as financial fixed assets (DAS 228.301).

Financial instruments
Receivables, securities and cash are financial instruments. Prepayments and accrued income are not financial instruments. DAS 222, 226, 228 and 290 contain specific guidelines on the recognition, measurement, presentation and disclosure of financial instruments. These guidelines are briefly discussed in this chapter. See Chapter 21 on financial instruments for more details on the reporting of financial instruments.

13.2 Recognition on the balance sheet

13.2.1 General

As a general criterion, an asset is recognised on the balance sheet when it is probable that future economic benefits will flow to the entity and the asset has a cost or value whose amount can be measured reliably. Assets that do not comply with this are not recognised on the balance sheet (DAS 115.104).

13.2.2 Receivables

The general recognition criterion mentioned above affects the recognition of receivables and current assets. Receivables from the sale of goods and the rendering of services are recognised only when the conditions for revenue recognition are met (DAS 270), as rights to receive cash usually only exist from that moment onwards. Thus, a receivable is recognised only when the customer is unconditionally obliged to pay the relevant amount.

Therefore, the conclusion of a contract will almost always be insufficient for the recognition of a receivable, because this also requires for the agreed performance obligation to have been fulfilled. In case of advance billing for goods or services to be supplied, the recognition or non-recognition of a receivable will depend on the terms of the contract and in particular on whether the contract is terminable.

Example: Advance billing (1)		
A company entered into a terminable contract on 1 December of year 1 to deliver a product to a customer on 31 March of year 2 for an amount of 1,000. According to the contract, that amount must be paid in advance on 31 December of year 1. A already invoices the customer for this amount on 15 December of year 1. The customer pays the amount on 1 February of year 2 and the product is delivered on 31 March of year 2. The contractual provision to prepay the amount on 31 December of year 1 does not result in a receivable to be recognised on the balance sheet. Since the contract is terminable, there is no enforceable contractual right to receive the amount. On receipt of the amount on 1 February of year 2 (before A delivered the product), A makes the following entry:		
Cash	1,000	
Amounts received in advance		1,000
On delivery of the product on 31 March of year 2, the following entry is made:		
Amounts received in advance	1,000	
Revenue		1,000

Example: Advance billing (2)		
The same as in the previous example, except that the contract is not terminable. The amount of 1,000 is due on 31 December of year 1. Sending the invoice on 15 December of year 1 does not result in a receivable. The reason is that sending the invoice does not result in an unconditional (and therefore enforceable) right to receive the amount from the customer. On 31 December of year 1, A does recognise a receivable because an unconditional right to receive the amount does arise on that date:		
Accounts receivable	1,000	
Amounts invoiced in advance		1,000
On receipt of the amount on 1 February of year 2, A makes the following entry:		
Cash	1,000	
Accounts receivable		1,000
On delivery of the product on 31 March of year 2, the following entry is made:		
Amounts invoiced in advance	1,000	
Revenue		1,000

Other receivables are recognised on the balance sheet when the related claim arises, as rights to receive cash exist at that time.

Netting
Net presentation of assets and liabilities is not allowed if they have to be recognised as separate items under Title 9 Book 2 NCC (Article 2:363(2) NCC). Netting of receivables against payables requires the entity (DAS 115.305):

- to have the power of set-off, which means that the entity will have a legally enforceable right; and
- to have the firm intention to settle the balance as such or both items simultaneously.

If an entity meets these conditions, netting must take place. There is no choice to net or not. See paragraph 2.9 for more details on netting of assets and liabilities.

Instalment purchase, rental and operating lease
Instalment purchase can be described as a transaction where the agreed purchase price is paid in a number of instalments. The instalment amounts include a fee for deferred payment. This fee basically consists of interest and administration costs. The selling party usually retains legal title until all instalments have been paid. For recognition in the financial statements, such a sale is split into a sales transaction and a loan granted. The sales transaction is recognised by including a receivable on the balance sheet at the time of delivery for the sales value of the goods

supplied on credit with recognising revenue in profit or loss as a contra entry. This makes the recognition method the same as that of a cash sale. Recognition also takes place in this way in case of lease-purchase transactions. Repayments received on the loan are deducted from the loan, while in addition, interest and administrative costs received concurrently with the repayment are credited to profit or loss.

In general, if leases or lease-purchases meet the definition of lease contracts, DAS 292 on leasing applies (DAS 292.104). See also Chapter 22.

Receivables related to government grants and other forms of government assistance
Government grants and other forms of government assistance are recognised when it is reasonably certain that the entity will comply with the specified conditions and will actually obtain the grant or facility (DAS 274.107). See Chapter 29.

Receivables related to loss suffered
Receivables from third parties related to a loss suffered are generally divided into two categories: receivables under a contractual relationship and other receivables. For the first category, for example under a guarantee claim, a receivable is recognised if, based on the relevant contract, it is probable that the claim will be allowed. The second category of receivables, such as claims on the basis of an unlawful act, is recognised on the balance sheet only to the extent that the claim has been admitted by the relevant third party and if the claim has been allowed to the entity at law. In case of a claim covered by an insurance company, the claim payment to be received is recognised on the balance sheet, provided it is probable that this claim payment will be received ('probability criterion') (DAS 212.455, see also paragraph 16.3 'Reimbursement by a third party').

Receivables subject to a pledge
As part of loans granted to the entity, a pledge on receivables of the entity may have been granted to the lender. This pledge may or may not take the form of a 'silent pledge'. A silent pledge means that debtors have not been informed of the existence of the pledge. If the entity fails to fulfil its obligations to the lender, the lender, as holder of the pledge, may collect the claim after notifying the debtor of the pledge. The existence of this pledge must be disclosed in the financial statements. This can be done in the notes to the relevant receivables or in the notes on the credit terms.

Assignment of receivables
In addition to pledging, receivables can be assigned. Someone who has a registered receivable from another party, and is unable or unwilling to collect that receivable themselves, can transfer, assign, the receivable to a third party (assignee). From the moment receivables have been transferred by assignment, they are no longer recognised on the balance sheet of the assignor (the party assigning the receivable), unless the significant risks and benefits associated with the receivable have not been transferred. See paragraph 21.5.2 on derecognition of a financial instrument, such as receivables.

Often, the debtor will be informed that the receivable from him has been transferred to the assignee. This is also known as the 'classic' way of assigning receivables. The legislator has also made it possible for receivables to be assigned without notifying the debtor ('silent assignment'). The conditions for this are (Article 3:94(3) NCC):

- the assigned receivable already exists at the time of the assignment, or will arise directly from a then pre-existing legal relationship (as, for example, a future interest claim arises from an existing loan contract); and
- the receivable is assigned by means of a for that purpose or authentic or registered private deed.

The silent assignment - following legislation in other countries - has been incorporated into Dutch property law for the benefit of securitisation practice. However, the assignment cannot be invoked against the debtor until the assignment has been notified to him. This means that the debtor can validly continue to pay to the assignor until that time. Also with this form of assignment, once assigned, the receivables are no longer recognised on the assignor's balance sheet unless significant risks and benefits associated with the receivable have not been transferred.

Factoring
Factoring is a special form of assignment. Here, receivables are transferred to a factor that is professionally engaged in the acquisition and management of receivables. If this factor takes over the debtor risk, the factor will include the receivable on its balance sheet. Therefore, these receivables are not recognised on the original creditor's balance sheet. See paragraph 21.5.2 on derecognition of financial instruments, such as receivables.

Receivables from shareholders
Receivables from shareholders relating to shareholders' equity to be paid up are recognised on the balance sheet only if and to the extent that the payment has been called up.

Receivables from director-major shareholder
Cash withdrawals from the entity by a director-major shareholder are usually presented in practice as receivables from the director-major shareholder. However, there may be circumstances under which, based on economic reality, such withdrawals do not classify as receivables, but as informal capital withdrawals. See paragraph 14.4.

Receivable from cash pooling
In group relationships, it is common to implement a central cash management (treasury) policy in order to carry out cash management within the group as (cost) efficiently as possible. An example of this central policy is the use of cash pools. In the case of physical cash pools, the positive balance is often transferred on a daily basis to the group entity that manages the central cash pool. In that case, the transferring entity creates a receivable from this managing group company. This receivable does not meet the definition of cash and cash equivalents because it does not include cash in hand, balances in bank and giro accounts or bills of exchange and cheques (DAS 940). According to the balance sheet models of BMJ, these receivables will have to be presented as receivables from group companies under current assets.

13.2.3 Prepayments and accrued income

Prepayments and accrued income include (DAS 224.102):

- prepaid amounts for costs charged to subsequent periods, e.g. insurance premiums, membership fees and subscriptions. These prepayments are capitalised because, generally, they may be considered to represent the value of a specific right (e.g. the right to insurance coverage or the rights resulting from memberships and subscriptions). However, unlike receivables, they do not lead to receipts;
- amounts yet to be received due to income in favour of previous periods, such as interest on bank balances and deposits, recoverable costs and suchlike.

Example: Prepayments and accrued income with respect to advertising and promotion expenses

Expenditure on advertising materials (including brochures, mail order catalogues and leaflets) is charged to profit or loss when the relevant materials are received (DAS 210.235, see paragraph 5.3.1). Consequently, prepayments and accrued income are recognised for prepaid amounts for advertising materials not yet received.

After all, these are expenses that should be charged to subsequent periods, in this case the period of receipt of the advertising materials. However, no item can be recognised as prepayment for advertising materials that have already been received from the supplier, not even if those materials are still kept 'in stock' by the entity and have not yet been distributed to customers or potential customers of the entity. The same applies to advertising materials that have already been produced but have not yet been delivered at the request of the entity and remain in storage at the supplier until distribution. In an economic sense, those materials are no different from materials held in stock by the entity itself. In both cases, their costs are not capitalised.

In certain cases, prepayments may cover several reporting periods. We see this for example when initial fees are paid in case of rights to IT services such as multi-annual software-as-a-service contracts. The question then also arises as to how to deal with the classification of the prepayments and accrued income on the balance sheet. See paragraph 5.3.1 and in particular the example included there.

13.2.4 Securities

An entity recognises securities on its balance sheet when contractual rights arise in respect of that instrument (DAS 290.701). This means that in many cases, the conclusion of the purchase contract is considered the moment the securities are recognised on the balance sheet (date of entering into a binding contract). Incidentally, it is also permitted to recognise the securities on the balance sheet at the time of delivery (date of transfer). If no contract is entered into, the time of delivery or payment of the securities will be decisive.

13.2.5 Cash

Cash, in line with the general recognition criterion, is recognised as an asset on the balance sheet when the cash in hand, balances in bank and giro accounts or bills of exchange or cheques are at the disposal of the entity. Deposits and suchlike may be included as cash if in fact they are immediately available (DAS 228.301). However, if immediate withdrawal of the deposit is not possible and the remaining term exceeds several weeks, the deposit is classified as a receivable.

13.2.6 Derecognition

As a general criterion, an asset is derecognised if a transaction results in all or virtually all rights to economic benefits and all or virtually all risks associated with the position being transferred to a third party (DAS 290.702). See also paragraph 21.5.2.

13.3 Measurement

13.3.1 Receivables

Measurement at initial recognition
Receivables should be measured at fair value at initial recognition. In an arm's length transaction, fair value at the time of the transaction will normally equal cost. Transaction costs should be included in the initial measurement. By applying the effective interest method, transaction costs are recognised as part of amortisation in the profit and loss account (DAS 222.201).

Subsequent measurement
Receivables should be measured after initial recognition at amortised cost. If there is no premium or discount and transaction costs, the amortised cost is equal to the face value of the receivables (DAS 222.202). Provisions for uncollectibility should be deducted from the carrying amount of the receivable; payment discounts and credit limitation surcharges should be deducted or added in accordance with the method for determining revenue (DAS 222.203). Credit limitation surcharge refers to negative discount to pay for the credit term. The paying party may deduct the surcharge upon timely payment.

An entity should assess at each reporting date whether there is objective evidence of impairment of a receivable or a group of receivables. If there is objective evidence of impairment, the entity should determine the amount of the impairment loss and recognise it in the profit and loss account (DAS 222.204).

An entity first assesses for all individually significant receivables on an individual basis whether there is objective evidence of impairment. For individually insignificant receivables, this assessment is made on an individual or collective basis. It is therefore permissible to determine the amount of impairment for individually insignificant receivables in a collectively static manner. This is usually done by analysing the age of a portfolio of receivables, determining impairment for each age category, based on empirical figures (often expressed as a percentage). An entity may not determine impairment dynamically (e.g. by using a percentage of revenue) (DAS 222.204).

Example: Impairment of receivables determined on a collective basis

A company has outstanding receivables of 700,000 at the end of year 1. As it involves many relatively small receivables (about 1,200 debtors), the company does not determine the provision for uncollectibility for each debtor. Based on historical data on uncollectible receivables and an ageing analysis of outstanding receivables, the amount of impairment is determined for each age category. In this way, it is possible to determine impairment on a collective basis.

Alternatively, an entity is allowed to determine impairments of receivables according to the expected credit loss model of IFRS 9 instead of the provisions of DAS 290 (incurred loss model) (DAS 290.101). This also applies to lease receivables and debit balances under construction contracts or contracts to sell goods or render services. See also paragraph 21.6.4.5.

13.3.2 Securities

Introduction
The Dutch Accounting Standards Board has devoted a separate standard to securities with DAS 226 'Securities'. Examples of common securities include shares, bonds, and derivatives. Securities fall under financial instruments, which are of course discussed in detail in DAS 290 'Financial instruments' and Chapter 21. This paragraph deals with the main provisions of DAS 226. Following DAS 226, this paragraph deals with the measurement of shares and bonds. For the measurement of financial instruments in general, including derivatives, reference is made to Chapter 21.

Measurement of shares and bonds at initial recognition
Shares and bonds should be measured at fair value at initial recognition. In an arm's length transaction, fair value at the time of the transaction will normally equal cost. Transaction costs directly attributable to the acquisition of the shares and bonds are included or excluded in the initial measurement, depending on the subsequent measurement (DAS 226.201):

- in case of subsequent measurement at fair value through profit or loss, transaction costs are recognised in the profit and loss account;
- in case of subsequent measurement at fair value through equity, transaction costs are recognised in the initial measurement; and
- in case of subsequent measurement at amortised cost, transaction costs are recognised in the initial measurement.

Subsequent measurement of shares and bonds
The measurement of shares and bonds after initial recognition depends on the classification of the securities, to be determined in accordance with DAS 290.4. After initial recognition, any shares and bonds (listed and unlisted) that belong to the category 'financial assets that are part of a trading portfolio' should be measured at fair value through profit or loss (DAS 226.203).

Listed shares belonging to the category 'investments in equity instruments' should be measured at fair value after initial recognition, with the option to either recognise changes in value directly in the profit and loss account or include them directly in the revaluation reserve, with realised changes in value being recognised in the profit and loss account (DAS 226.204).

Unlisted shares belonging to the category 'investments in equity instruments' should be measured at cost or fair value after initial recognition. If measurement is at fair value, changes in value must be recognised directly in the profit and loss account or included directly in the revaluation reserve, with realised changes in value being recognised in the profit and loss account (DAS 226.205). When measured at cost, only realised changes in value and impairment losses should be recognised in the profit and loss account.

Bonds (listed and unlisted) belonging to the category 'purchased loans and bonds' and held to maturity should be measured at amortised cost (DAS 226.206). Bonds belonging to the category 'purchased loans and bonds' that are not held to maturity may be measured at amortised cost or at fair value. If measurement is at fair value, changes in value must be recognised directly in the profit and loss account or included directly in the revaluation reserve, with realised changes in value being recognised through profit or loss (DAS 226.208).

When recognising impairment losses, no negative revaluation reserve may arise under Article 2:390 NCC, unless cash flow hedge accounting is applied (Article 2:384(8) NCC). See paragraph 14.3.7 for more details on the revaluation reserve.

Usually, a reliable fair value will not be readily identifiable for unlisted shares and bonds. In that case, under Article 10(1) BAW, the fair value is approximated by:

- deriving it from the fair value of its constituent elements or of a similar instrument if a reliable market can be identified for its constituent elements or for a similar instrument; or
- using generally accepted valuation models and valuation techniques.

If it is not possible to determine a reliable fair value using the above approaches, the relevant shares and bonds are measured at cost (Article 10(3) BAW).

Several methods are applicable for the write-down of shares and bonds measured at cost to the lower fair value:

- individual assessment (by type of shares or bonds);
- collective assessment (write-down to lower fair value only to the extent that the total fair value of a group of shares or bonds is less than the total cost of the group); or
- consistent measurement at 'cost or lower market value'.

See paragraph 21.6.4.5 for further provisions on impairment. It also discusses an alternative option allowed by the Dutch Accounting Standards Board. That alternative involves allowing an entity to apply the expected credit loss model of IFRS 9 instead of the provisions of DAS 290 (incurred loss model) for determining impairment (DAS 290.101).

13.3.3 Cash

In general, cash is measured at face value (DAS 228.201). In special cases, cash may be measured at a lower value pursuant to Article 2:387(2) NCC. If funds are not freely available, this should be taken into account in the measurement (DAS 228.201). An example is cash that is not freely available due to transfer restrictions in a particular country which make the transfer of these funds impossible or economically unfavourable. This does not include cash in a so-called G account (*g-rekening*), which may only be used to pay wage tax and social security contributions. Only the spending options of this cash are limited.

13.4 Disclosures

13.4.1 Receivables and prepayments and accrued income

The notes explain the measurement bases. For receivables, this usually means stating that measurement is at face value less a provision for expected uncollectibility.

The categories of receivables should be apparent either from the balance sheet itself or from the notes. They include (Article 2:370(1) NCC):

- trade receivables;
- receivables from group entities;
- receivables from other entities and companies that have a participating interest in the entity or in which the entity has a participating interest;
- issued capital called but not paid up; and
- other receivables, with the exception of those to which Article 2:371 NCC (securities) and Article 2:372 NCC (cash) apply and with separate disclosure of receivables from loans and advance payments to members or holders of registered shares.

The balance sheet or notes also disclose the amount of receivables from participating interests in which the entity can exercise significant influence, distinguished into current and non-current (DAS 222.313).

For each category of receivables, the amount of the receivables whose residual term exceeds one year is disclosed (Article 2:370(2) NCC). If receivables with a remaining term of more than one year are classified in a total amount under current assets, the notes shall indicate, pursuant to Article 2:370(2) NCC, the amount of the receivables whose remaining term exceeds one year (DAS 222.306).

Prepayments on inventories or tangible fixed assets are classified under the items inventories and tangible fixed assets respectively (DAS 222.307).

Credit balances of debtors are presented as debt, while debit balances of creditors are presented as receivables.

With regard to (current) management board members jointly and (current) supervisory board members jointly, pursuant to Article 2:383(2) NCC, information is provided on receivables from loans and advance payments made to them. These are:

- amounts outstanding on loans, advance payments and guarantees;

- the interest rate;
- repayments during the financial year;
- the amounts written down and the amounts waived; and
- the principal other (special) provisions.

By companies complying with Article 2:383b NCC (non-listed public limited liability companies), the information as described above is provided separately for each individual management board member and each individual supervisory board member. Incidentally, this information need only be disclosed in the notes to the company-only financial statements.

When receivables are pledged, the notes state for which receivables this has been done (see Chapter 21), indicating the total amount of receivables pledged.

The nature of the prepayments and accrued income, if important for the insight referred to in Article 2:362(1) NCC, is expressed either by classification on the balance sheet, by specific designation or by further explanation in the notes (DAS 224.102). It is recommended to present the amount of the prepayments and accrued income separately on the balance sheet only if their amount is of sufficient significance and in other cases to aggregate the amount with other receivables (DAS 224.105). If prepayments and accrued income are presented separately under current assets in the balance sheet, the notes must indicate the amount up to which the remaining maturity is longer than one year (DAS 224.106). For the classification of prepayments and accrued income as current or non-current assets, reference is made to DAS 190.2 'Distinction between fixed and current' (DAS 224.102). See also paragraph 2.11.

13.4.2 Securities

The notes explain the measurement basis.

If securities are measured at cost and the fair value is higher, the higher fair value is disclosed in the notes (DAS 226.303).

Pursuant to Article 2:371 NCC, the following categories of securities are presented on the balance sheet or in the notes:

- shares and other forms of interests in other associated entities;
- other securities.

Hereby is disclosed the extent to which securities are not freely available to the entity.

See Chapter 21 for the general disclosure requirements of financial instruments.

13.4.3 Cash

If cash is not (expected to be) available to the entity for more than 12 months, it should be classified as financial fixed assets (DAS 228.301). The notes disclose the measurement basis used for cash. A breakdown of cash is not required by law. The notes do state the extent to which funds are not freely available to the entity (Article 2:372(2) NCC). If significant restrictions exist on the availability of cash, the nature of the restrictions and the size of the amount not freely available are disclosed (DAS 228.302).

13.5 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

With regard to receivables, small entities are exempt, pursuant to Article 2:396 NCC, from separately disclosing the groups included under current assets as set out in Article 2:370(1) NCC, with the exception of separately disclosing issued capital called but not paid up (Article 2:396(3) NCC).

The Dutch Accounting Standards Board has exempted small entities from the requirement to measure listed shares at fair value. For the measurement of listed shares, small entities may choose between measurement at cost (or lower market value) and measurement at fair value. If measurement is at fair value, all changes in value may be recognised directly through profit or loss.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

13.6 Significant differences from IFRS

Financial instruments
With regard to financial instruments (including securities), there are significant differences from IFRS. These differences are addressed in Chapter 21.

Cash
Under IFRS, cash equivalents are presented under the same heading as cash (‘cash and cash equivalents’). Under NL GAAP, cash equivalents may not be presented under cash and cash equivalents but, depending on their nature, must be presented under receivables or securities. See paragraph 25.3.1 for the definition of cash equivalents.

14 Equity

14.1 Introduction

General
The amount of equity is shown in an entity's financial statements. It may therefore seem strange that there is relatively little regulation in accounting and reporting rules on the term 'equity'; unlike in capital protection law. However, this can be explained by the fact that equity is considered a 'residual item' in the financial statements. The definition of equity is therefore simple, namely the balance of separately measured (groups of) assets and separately measured (groups of) debt, provisions and accruals (DAS 110.111). In other words, the residual interest in the assets of an entity after deducting all liabilities (DAS 240.0). Thus, the amount of equity can only be determined indirectly, namely by determining the amount of assets and the amount of liabilities. The amount of equity shown does not have the function of approximating the value of an entity.

Classification based on economic reality or legal form
In the consolidated financial statements, the distinction between equity and liabilities is determined by the economic reality of the contractual provisions. See paragraph 21.8 for a discussion of DAS 290 on the classification of financial instruments as either equity or liabilities in the consolidated financial statements.

Even in the company-only financial statements, the distinction between equity and liabilities can be determined based on the economic reality of the contractual terms. In that case, the provisions of DAS 290 discussed in paragraph 21.8 also apply (DAS 240.208).

In the company-only financial statements, the distinction between equity and liabilities can also be determined based on the legal form (DAS 240.207 and 208). In this case, a financial instrument that has the legal form of a liability at reporting date is presented as a liability in the company-only financial statements. This is a policy choice that should be applied consistently. The total of financial instruments that are classified as liabilities based on economic reality but are accounted for in the company-only financial statements as equity based on their legal form at reporting date, is presented separately within equity (DAS 240.207). For each instrument included herein, the principal conditions should be disclosed.

An example cited by the Dutch Accounting Standards of an instrument that has the economic characteristics of equity but the legal form of a liability involves a perpetual bond loan with no maturity date or redemption obligation where the payment of interest is at the discretion of the issuing entity (DAS 240.209). For certain preference shares, the reverse may be true. These are presented in the company-only financial statements as equity based on the legal form, but may have the economic characteristics of liabilities (see paragraph 21.8).

The choice in favour of classification as equity based on economic reality or legal form also has implications for presentation in the profit and loss account. For example, dividend payments on shares classified as equity are recognised directly in equity. In contrast, dividend payments on shares classified as liabilities are recognised as interest expenses. See also paragraph 21.8.5. For the presentation and disclosure requirements of financial instruments classified based on legal form, please refer to paragraph 3.1 of this chapter.

Case law on classification based on legal form (GGN judgments)
In the financial statement proceedings involving GGN Brabant (2016 financial year) and GGN Holding (2017 financial year) (henceforth 'GGN judgment') (inter alia, ECLI:NL:GHAMS:2019:310), the Enterprise Chamber (EC) gave further and important interpretation to the classification of equity instruments based on the 'legal form' principle. Briefly, the situation submitted in the dispute was that shareholders of the entity, upon terminating the cooperation contract with the entity, had to sell back their shares and depository receipts to the entity within a number of working days. The entity then had a duty to buy back these shares for a purchase price determined based on the arrangements in the cooperation contract. Due to a shortage of liquidity, the delivery of the shares was postponed until the parties could agree on a subordinated loan to be provided to the entity on market terms. The disputed financial statements had thus created the situation where a repurchasing obligation at an agreed purchase price existed on the reporting date, but where, from a property law point of view, the original shareholder (the plaintiff) was still entitled to the shares. GGN classified the shares as equity in the company-only financial statements (legal form basis), to which the plaintiff objected. The plaintiff believed that the amount to be repaid should be charged to equity and presented as a liability.

The EC ruled in this dispute that GGN wrongly classified the instruments to be repurchased as equity. According to the EC, the term 'the legal form' should be interpreted to mean that obligations arising from the proprietary right are accounted for as parts of the entity's liabilities. In this context, the EC ruled that if the legal position of the holder of the instrument is materially similar to that of the provider of debt capital, the instrument should be classified as a liability. Here, the EC pointed out the essential function of the delineation of equity and liabilities for providing the legally required insight into equity and profit or loss. The purely property law interpretation advocated by GGN therefore did not meet this requirement, according to the EC. The Netherlands Supreme Court dismissed the cassation appeal in both proceedings in 2020, thus upholding the EC's ruling (inter alia, ECLI:NL:HR:2020:1137).

In our view, this ruling by the EC means that in two situations, instruments with the legal form of equity should be presented in the company-only financial statements as liabilities (i.e. without prejudice to the choice of basis based on legal form or on economic reality):

1. if there is an unconditional obligation to repurchase/redeem the instrument. This is because, in property law terms, the equity has only been made available to the company for a certain period of time. The legal status of the holder of this instrument is then similar to that of a provider of debt capital;
2. if there is a contingent obligation in the contract to repurchase/redeem even though the relevant condition has since been met on the reporting date. On the reporting date, therefore, there is an actual obligation to repurchase/redeem. This is the situation in the GGN judgment. This could include the situation of issued shares provided with put options. If the option holders have notified the entity that they wish to exercise their right to sell the shares to the entity at the contractual exercise price, in property law terms they are in a position of provider of debt capital from that moment on, even if the shares have not yet been delivered to the entity on the reporting date.

Share capital
In companies that have share capital, several legal terms are distinguished with regard to equity. Shares means the portions into which the authorised share capital is divided according to the articles of association (Article 2:79(1) NCC). Rights that do not include voting rights nor entitlement to distribution of profits or reserves are not classified as shares (Article 2:190 NCC). Share capital is the capital of the public limited liability entity (NV) or private limited liability entity (BV) divided into shares.

Authorised share capital refers to the maximum amount of share capital that the entity can issue under its articles of association. Issued share capital refers to the portion of the authorised share capital issued. A BV does not need to have authorised share capital.

Paid-up share capital is the part of the issued share capital that has been paid up. The term paid-up and called-up share capital includes the paid-up part of the issued share capital as well as the payments already called up by the NV or BV but not yet received by the company.

Minimum share capital is the minimum share capital that must be issued and paid up pursuant to legal provision. For an NV, the legal minimum share capital is €45,000. BVs are not required to hold minimum share capital.

Guarantee capital
In practice, one regularly encounters – usually in the consolidated but sometimes in the company-only financial statements too – the terms liable capital or guarantee capital (sometimes also called resilience capital). These are not legal terms. This usually refers to a combination of equity and liability components where the liability components are subordinated in seniority (e.g. subordinated loans). A continuous list of items belonging to the guarantee capital is not usually possible, because of the prescribed balance sheet models (Decree on annual accounts format, BMJ). However, it is possible to disclose the amount of the guarantee capital in the notes. The composition of the guarantee capital should be clear from the financial statements, with items of a current nature not allowed to be included in the guarantee capital (DAS 240.244 and 240.305).

In practice, the balance sheet item subordinated loans is sometimes included directly under equity, after which guarantee capital is shown by means of subtotalling. However, such a statement is not possible if there is a provision item on the credit side of the balance sheet. This is because the order (continuous list) of balance sheet items should comply with the prescribed balance sheet models (Article 6 BMJ). If no provision item is included on the credit side of the balance sheet, such a statement is usually only possible if all non-current debt consists of subordinated loans. This is because debts have to be recognised separately (Article 2:364(4) NCC) and, according to the BMJ, be split into non-current debt and current debt. Moreover, Article 5(1) BMJ states that these titles may not be deviated from. Furthermore, Article 5(4) BMJ provides that the grand totals mentioned in Articles 2:364 to 377 NCC, including debt, may not be left undefined. This means that de facto all debt should be included under either non-current debt or current debt. It is therefore not possible not to present certain debt (in this case, the subordinated loans) as part of (non-current or current) debt. However, it is possible to follow a presentation in which it is indicated below the balance sheet which balance sheet items (e.g. marked with an *) are included in the guarantee capital. It is also possible to disclose the amount of the guarantee capital in the notes. There is sometimes ambiguity as to which subordinated debt can belong to the guarantee capital. There is some parallel here with the disclosure of the amount up to which debt is subordinated to other debt (Article 2:375(4) NCC). This involves – according to the legislative history – a subordination to *all* other creditors; a debt that is not generic but is only subordinated to certain other creditors does not need to be disclosed separately in this way in the notes, unless it is necessary for insight. By analogy, only such generically subordinated loans can be part of the guarantee capital. This is because only debt that is subordinated to all other creditors contributes to the company's risk-bearing capital in an economic sense.

Even if, based on the above, subtotalling guarantee capital on the credit side of the balance sheet were possible, we would still advise against it. After all, it may well be that in a subsequent balance sheet period, unsubordinated non-current debt is incurred or, alternatively, provisions need to be accounted for. If so, subtotalling is still not possible. Anticipating a sustainable consistency of balance sheet presentation, we recommend separate disclosure in notes or the use of asterisks on the balance sheet when it comes to the presentation of guarantee capital.

In the consolidated financial statements, a debt can only be included under guarantee capital if, according to the financing contract, this subordination applies to the debt of all group entities. This also applies when the subordination does not formally apply in relation to all debt of the consolidated entities, but – as a result of intercompany liabilities – there is substantially subordination in relation to all other debt included on the consolidated balance sheet (DAS 254.309). In the case of a subordination to a single lender, for example in the context of group financing, classification as guarantee capital is not possible.

14.2 Capital protection

14.2.1 Introduction

There is a relationship between annual reporting and capital protection law. Equity, especially the non-distributable (tied) part of that equity, plays a central role in capital protection law. For example, if an NV or BV wishes to make a distribution to shareholders, in the form of a dividend distribution or a distribution from the free reserves, there must be sufficient (free) availability within the equity for this distribution (Articles 2:105 and 216 NCC). More or less the same applies if the NV or BV wishes to buy back its own shares. For that too, there must be sufficient free availability within equity (Articles 2:98 and 208 NCC). The determination of whether sufficient free availability exists for an (interim) distribution of profit to shareholders or for a repurchase of own shares is made on the basis of:

- the item equity as shown in the company-only financial statements, or
- the interim figures prepared in accordance with the fixed presentation in the financial statements.

Even if a Dutch entity prepares company-only financial statements in accordance with IFRS-EU, the legal reserves must be included in these company-only financial statements (Article 2:362(9) NCC).

14.2.2 Public limited liability entity (NV)

At its core, the tied, non-distributable, equity of an NV consists of the share capital as well as the statutory and legal reserves. The distributable (free) availability within equity then consists of total equity less the non-distributable part of equity. Distributable equity normally consists of the share premium reserve and Other reserves. On any distribution or repurchase of own shares it must be determined whether there is sufficient free availability within equity. This is the so-called balance sheet test.

In case of a private limited liability entity (BV), in addition to the balance sheet test, a distribution test is also required (see below). This distribution test is formally not necessary for a NV. In a material sense however, management board members of a NV will also have to act prudently when executing distribution decisions. This is because case law shows that also in the case of a NV management board members can be liable for improper performance of duties if they participate in irresponsible distributions.

14.2.3 Private limited liability entity (BV)

For a BV, in case of distributions (including repurchasing of own shares), both a balance sheet test and a distribution test must take place.

Balance sheet test
BVs are not required to hold minimum share capital. The share capital of a BV is therefore not part of the non-distributable, tied capital. Distributions (and repurchasing of own shares) are permitted to the extent that equity exceeds legal and statutory reserves. If there are no legal or statutory reserves, a distribution may even result in equity becoming negative, provided the distribution does not jeopardise continuity.

Example: Balance sheet test (1)

The equity of private limited liability entity X consists of share capital (18,000), share premium (32,000), and a general reserve (100,000). Total equity is therefore 150,000. The shareholders of X BV make a proposal to distribute 250,000 in dividends. Since there are no legal or statutory reserves, there is no need to carry out a balance sheet test. The distribution test (see below) will have to show whether the proposed distribution is permissible.

If legal or statutory reserves do exist, the outcome of the balance sheet test is the maximum amount that can be distributed. At least, if the distribution test also comes out positive. Distributions made contrary to the outcome of the balance sheet test are void and may be reclaimed.

Example: Balance sheet test (2)

Private limited liability entity X from the previous example decides to measure property at current value. The resulting revaluation is 100,000. After deduction of deferred corporate income tax at 25%, the revaluation reserve is 75,000. Total equity is then 225,000. A distribution may not result in equity falling below the legal reserves of 75,000. A maximum amount of 150,000 can then be distributed, provided the outcome of the distribution test is also positive. Choosing measurement at current value limits the distributable amount in this example. It is therefore important to realise that the accounting principles chosen, to the extent that they result in legal reserves, may have implications for potential distributions to shareholders.

Limiting the distributable amount in the presence of legal or statutory reserves is inconsistent with the situation where, in the absence of legal and statutory reserves, equity may even become negative through distribution. This has also been recognised by the legislator, indicating that this necessarily follows from the Fourth EC Company Law Directive (now replaced by the EU Accounting Directive) and the Second EC Directive on capital protection. This is because it stipulates that legal reserves may not be distributed. We further note that all distributions must also meet the distribution test.

Distribution test
In the case of a private limited liability entity, distributions require the approval of the management board. Directors must refuse approval if they know or should reasonably understand at the time of the distribution that the company cannot continue to pay its due debt after the proposed distribution (Article 2:216 NCC). Directors will therefore have to assess, on pain of potential liability, whether the company will be able to continue paying its due debt after the distribution. That assessment is called the distribution test. In the case of a BV, therefore, the actual freely distributable capital cannot be read from the financial statements.

It follows from the legislative history that the distribution test should consider all relevant factors. Specifically, liquidity, solvency and profitability are mentioned. Nevertheless, it is important to note that however as much as factors such as liquidity and solvency may play a role in the assessment, the ultimate criterion remains whether a company can continue to pay its due debt after the distribution. The choice of the term 'due debt' is in line with the regulation for suspension of payments in the Bankruptcy Act. The moment the company foresees that it will no longer be able to proceed with the payment of its due debt, it can apply for suspension of payments. The directors are thus expected, under the distribution test, to assess at the time of the distribution whether, after making the distribution, the company will end up in a situation of suspension of payments in the foreseeable future. The period over which the assessment will have to extend will generally be about a year, but in special circumstances it may be longer. Such special circumstances may arise, for example, if the management board knows that a significant loan repayment is due in more than a year's time.

Example: Distribution test (1)

The equity of private limited liability entity X consists of share capital (18,000), share premium (32,000), and a general reserve (200,000). Total equity is therefore 250,000. The balance sheet total is 500,000. Solvency (expressed as a percentage of equity to total assets) is 50%. The company's profit (EBITDA) and operating cash flow are relatively stable and consistently positive. No significant changes are expected in this in the foreseeable future. The shareholders of X make a proposal to distribute 50,000 dividends. Therefore, after the proposed dividend distribution, solvency will be 40%, which can be considered ample. No liquidity or funding issues are expected after the distribution either. The management board may not refuse to approve the dividend proposal.

The management board's judgement on the permissibility of the distribution may depend, among other things, on how probable it is that the company will be able to generate or attract financing over a sufficient period of time to meet its borrowing requirement. To this end, among other things, future cash flows will have to be forecasted, based on existing and expected revenue and profit or loss, fixed asset investments and working capital expansions. This will involve not only the financial situation and future prospects of the company, but also the general availability of credit for companies in a similar situation.

Example: Distribution test (2)

Private limited liability entity Y's equity consists of share capital (18,000), share premium (32,000), and a general reserve (100,000). Total equity is therefore 150,000. The balance sheet total is 500,000. Solvency (expressed as a percentage of equity to total assets) is 30%. The company's profit (EBITDA) and operating cash flow are relatively stable and consistently positive. No significant changes are expected in this in the foreseeable future. Y is making use of a bank loan of 200,000. A condition for the bank loan is that the company's equity must be at least 25% at all times. Y's shareholders make a proposal to distribute 50,000 dividend. This would reduce the solvency to 20% and the loan would become payable immediately. The resulting borrowing requirement cannot be expected to be financed in the current capital market. The management board should refuse to approve the dividend proposal.

Given the multitude of factors that may come into play, in our opinion, a more or less detailed cash flow forecast will usually have to be drawn up with corresponding balance sheet projections, with the resulting borrowing requirement being checked against the available credit availability. In this way, the management board can make a well-founded assessment of whether or not the company, after making the distribution, will end up in a situation of suspension of payments in the foreseeable future.

Example: Distribution test (3)

Private company Z's equity consists of share capital (18,000), share premium (232,000) and a general reserve (750,000). Total equity is therefore 1 million. The balance sheet total is 3 million. Solvency (expressed as a percentage of equity to total assets) is 33%. The company's profit (EBITDA) and operating cash flow (EBITDA) are relatively stable and consistently positive. No significant changes are expected in this in the foreseeable future. There are no liquidity or funding issues. Z's shareholders make a proposal to distribute 250,000 dividend. This would reduce solvency to 25%, which would be sufficient under normal circumstances. To continue profitability, it has recently been decided to expand the product range. If this is not done, it is probable that a significant number of customers will be lost. Expanding the range requires an investment in working capital. In addition, limited investments in tangible fixed assets are required. A liquidity forecast prepared by management based on the budget for the coming year (including the planned investments) shows that liquidity stress will occur even without dividend distribution. It is therefore a real possibility that after making a distribution of 250,000 in the coming year, the company could be entering suspension of payments. The management board should refuse to approve the dividend proposal.

The distribution test can also play a role in determining the amount of the legal reserve for participating interests. Paragraph 14.3.8 discusses this in more detail.

14.2.4 Distributions contrary to the balance sheet test

It may happen that a distribution has been found to be contrary to the balance sheet test after the distribution has been made. In particular, we will focus on the consequences for further recognition in the financial statements.

A distribution that took place but was in conflict with the balance sheet test of Article 2:105 NCC (public limited liability entity) or 2:216 NCC (private limited liability entity), is void to the extent that an overpayment has been made. This means that it is deemed that the decision to distribute was not made. As a result, a receivable due to undue payment must be recognised for the 'excessive' part of the distribution. This receivable is directly reversed in equity, in fact as a correction to the recognition of the dividend. In this way, the situation is presented as if no decision to distribute was ever made.

Example: Distribution contrary to balance sheet test

The equity year-end year 1 of private limited liability entity X consists of share capital (18,000), share premium (32,000), a general reserve (100,000) and a revaluation reserve of 75,000. The total equity is therefore 225,000. The revaluation reserve concerns a legal reserve. A distribution may not result in equity being less than the legal reserves amounting to 75,000 (balance sheet test).

In year 2, the company decides to distribute an interim dividend of 125,000. In year 2, however, an acquisition under common control also takes place, which reduces the equity of X by 200,000 by applying 'carryover accounting' (see paragraph 31.6). When preparing the financial statements for year 2, it appears that the total of equity amounts to 50,000 negative. The legal revaluation reserve at the end of year 2 amounts to 60,000.

If the interim dividend distribution had not been made, the total of equity would have been 75,000 positive (= -50,000 + 125,000). The free distributable equity would then have been 15,000 (= 75,000 - 60,000). This means that 110,000 (= 125,000 - 15,000) too much interim dividend has been distributed. With the state annulment of the decision to distribute the interim dividend, the situation on the balance sheet at the end of year 2 must be presented as if the interim dividend for an amount of 110,000 *had not* taken place. If the interim dividend of 125,000 has been distributed, a receivable from X’s shareholder of 110,000 will be recognised by virtue of undue payment. The remainder of the interim dividend (i.e. the amount of 15,000) has been distributed lawfully and will be deducted from the free reserves. The equity then amounts to 60,000 (= 75,000 – 15,000) at the end of year 2, which is equal to the legal reserves. Therefore, when adopting the financial statements for year 2, X cannot declare an additional final dividend.

The consequences of any dividend taxes have been abstracted from in this example.

14.3 Presentation and disclosure

14.3.1 Presentation in balance sheet and equity movement schedule

Models for the layout of the balance sheet and profit and loss account are laid down in the Decree on annual accounts format (BMJ). Use of these models is prescribed for NVs and BVs (Article 2:363(6) NCC). Naturally, the layout of the credit side of the balance sheet consists of the classifications equity and liabilities including provisions.

In the company-only financial statements, the following equity items are shown separately on the balance sheet (Article 2:373(1) NCC):

- issued share capital, or paid-up (and called-up) share capital (paragraph 14.3.2);
- share premium (paragraph 14.3.6);
- revaluation reserves (paragraph 14.3.7);
- other legal reserves, distinguished by type (paragraph 14.3.8);
- statutory reserves (paragraph 14.3.9);
- other reserves (paragraph 14.3.10);
- undistributed profits, with separate disclosure of the profit or loss after tax for the financial year, to the extent that its appropriation is not reflected on the balance sheet (paragraph 14.3.11).

The notes to the financial statements must include an equity movement schedule showing (Article 2:378 NCC):

- the amount of each item at the beginning and end of the financial year;
- the additions and deductions of each item for the financial year, broken down by their nature.

This movement schedule is included in the notes and forms part of the notes to the company-only financial statements. The equity movement schedule must also include the comparative figures for the previous financial year (DAS 240.237). The consolidated financial statements, being the financial statements of the group prepared by the parent entity, need not include an equity movement schedule. Nor is it necessary to break down equity in the consolidated financial statements. This breakdown is only prescribed in the company-only financial statements (Articles 2:410(1) and 411(1) NCC).

Presentation and disclosure requirements if classification based on legal form is chosen
If it has been decided to base the classification of a financial instrument as equity on its legal form (see paragraph 14.1), a separate item must be recognised within equity for financial instruments that classify as liability based on the economic reality (DAS 240.207). The standards specify the amount at which such an instrument should be presented separately in equity. That is the amount that would be recognised as a financial liability according to the economic reality. If there are different types of such financial instruments (e.g. preference shares and a written put option to purchase own shares), they are either presented on the balance sheet as separate items of equity per type of financial instrument, or the total amount of these instruments is presented as a separate item of equity, with the amount per instrument disclosed in the notes. In the notes, this (total) amount should be subdivided into the categories of equity, as mentioned in Article 2:373(1) NCC. For each of these instruments, the principal conditions must be disclosed (DAS 240.207).

14.3.2 The issued share capital

Issued, paid-up or paid-up and called-up share capital
The first item of equity should be issued share capital (Article 2:373(1) NCC). If the issued share capital is not fully paid up, then the paid-up share capital is disclosed instead or, if calls are issued, the paid-up and called-up share capital. The issued share capital is disclosed in the latter cases (Article 2:373(2) NCC).

Method of payment on shares and initial measurement
Article 2:80a(1) NCC (for NVs) and Article 2:191a(1) NCC (for BVs) stipulate that payment on a share must be made in cash insofar as no other contribution has been agreed. Such 'other contribution' is also referred to as a contribution in kind.

Cash payment or a contribution in kind are generally recognised for the first time at fair value at the time of contribution (DAS 240.206). This recognition is also mandatory if the payment or contribution falls within the scope of DAS 216 'Mergers and acquisitions' and is recognised using the purchase accounting method described in paragraph 31.3.

Even if informal capital contributions are made in kind, initial recognition will generally have to be at fair value. An important area of exclusion covers mergers and acquisitions under common control where application of the pooling of interests method and the carryover accounting method, respectively, are permitted. Please refer to paragraph 31.6.

Presenting share capital in foreign currency
The share capital of a Dutch NV is denominated in Dutch currency. That is, in euros or – if no amendment to the articles of association has been made since 2002 – in guilders. The share capital of a Dutch BV can also be denominated in another currency. Financial statements may be prepared in a foreign currency if the activity of the entity or the international presence of the group so warrants (Article 2:362(7) NCC). If the financial statements are prepared in a currency other than that in which the share capital is denominated, the item issued (or paid-up and called up) share capital is translated at the closing rate (Article 2:373(5) NCC). This exchange rate and the amount of the issued share capital in the currency unit in which the shares are denominated must be disclosed. The exchange difference arising on this translation should be recognised in Other reserves (DAS 240.205). See also the example given in paragraph 4.4.1.

Notes to shares issued during the financial year
The notes must disclose the manner in which payments on shares were made or became due during the financial year (Article 2:378(3) NCC). If certain legal acts were performed in the process, their substantive content must be disclosed. This relates to the legal acts referred to in Articles 2:94, 94c and 204 NCC (see annex 'Some provisions of Book 2 NCC').

14.3.3 Capital reduction through cancellation or through reduction of the nominal amount

The (issued) share capital of an NV or BV can be reduced; there is a special procedure for this in law (for NVs in Article 2:99 and 100 NCC and for BVs in Article 2:208 NCC). Characteristic features of this procedure for an NV are that a resolution of the general meeting to reduce share capital must be published by being filed with the Trade Register as well as through an announcement in a nationally distributed newspaper (Article 2:100(1) NCC) and that creditors can file an opposition to the proposed share capital reduction resolution within two months (Article 2:100(3) NCC). In the event of opposition, the NV must provide security or give guarantees for payment of its receivable for any debtor who so requests. A simplified procedure applies to BVs. In addition to a resolution of the general meeting (Article 2:208(1) NCC), only a distribution test is required (Article 2:208(6) NCC). For further explanation of the distribution test, see paragraph 14.2.2.3.

There are two types of share capital reduction: cancellation, and reduction of the nominal amount of the shares. Shares held by the NV or BV itself or a certain class (one type) of shares, can be cancelled. Cancellation of shares requires a resolution of the general meeting. After cancellation of shares, the amount paid on the shares can be repaid to shareholders. Alternatively, the nominal amount of the shares can also be reduced. Reduction of the nominal amount of the shares without repayment is called 'afstempeling' in Dutch. A reduction in the nominal amount of the shares can also take place with repayment of the amount to shareholders. In that case, the management board of the BV should approve this under the distribution test (Article 2:208(7) NCC). Reducing the nominal amount of the shares requires a further resolution of the general meeting and an amendment to the articles of association.

As indicated above, shares held by an NV or BV itself can be cancelled. It frequently happens in practice that after a share buyback, these repurchased shares are subsequently cancelled. When shares are cancelled, the number of issued shares is reduced. On the balance sheet, the issued share capital is reduced by the face value of the shares cancelled, with a simultaneous increase in Other reserves. Any payment to shareholders is deducted from Other reserves. Also, the share premium related to these shares can be transferred to Other reserves.

Example: Cancellation

Public limited liability entity A has 2,000 issued and paid-up shares with a face value of 10 per share. A proceeds to cancel 200 shares. The face value of the cancelled shares then totals 2,000 (= 200 x 10). The table below illustrates the impact of this cancellation:

	Before cancellation	Cancellation	After cancellation
Issued and paid-up share capital	20,000	(2,000)	18,000
Other reserves	1,000	2,000	3,000
Visible equity	21,000	0	21,000

Clearly, the equity position after this cancellation does not look different from before, but the cancellation does have economic significance because the Other reserves that are distributable have been increased by 2,000, and the issued share capital (which is non-distributable in the case of an NV) has been reduced by 2,000.

With the *afstempeling* of shares, the face value of issued shares is reduced by the reduction amount. At the same time, in accordance with the proposal for a reduction of the nominal amount, there will be an increase in the share premium or Other reserves (DAS 240.217). Such a reduction is usually applied if the company has a large issued share capital and also substantial accumulated losses. The following example makes this clear.

Example: Reduction of the nominal amount

A BV has 3,000 issued and paid-up shares with a face value of 10 per share. The BV proceeds with a reduction of the nominal amount by 3 per share. The face value is thus reduced to 7 per share. The reduction therefore totals 9,000 (= 3,000 x 3). The table below illustrates the effect of this reduction:

	Before reduction	Reduction	After reduction
Issued and paid-up share capital	30,000	(9,000)	21,000
Other reserves	(9,000)	9,000	0
Visible equity	21,000	0	21,000

What is clear is that the equity position after this reduction looks visually better than before. Incidentally, in a loss-making situation, such reduction does make economic sense. After all, in a loss-making situation, a reduction facilitates the issue of shares to a new shareholder. The visible equity is no longer lower than the face value of the shares after the reduction of the nominal amount. If it does, a new shareholder will usually be unwilling to pay up the face value, and issue below face value is not possible.

In the movement schedule, the item paid-up and called-up share capital is broken down by share type. The closing balance and details of the movement of the NV's or BV's own shares and of the depository receipts for these shares, held or caused to be held by such NV or BV itself or a subsidiary (for its own account), are disclosed separately. Disclosure is made of the item of equity from which the purchase cost or carrying amount thereof has been deducted (Article 2:378(2) NCC).

The manner in which payments were made on shares that became due or were made voluntarily during the financial year is disclosed. Furthermore, the substantive content of the legal acts performed in the financial year to which one of the following articles applies is disclosed: Article 2:94, 94c, 204 or 204c NCC (Article 2:378(3) NCC). It is recommended that if the issued share capital differs from the paid-up and called-up share capital, the notes should include a breakdown by share type (DAS 240.237).

14.3.4 Contributions related to shares for future issue

If an NV or BV obtains receipts in cash or in kind from third parties in exchange for the obligation to issue shares in the future, these funds are accounted for in Other reserves if and to the extent that they are not required to satisfy the legal payment obligation (of third parties) on the shares to be issued. If these are receipts pursuant to a contract, intended to meet the legal payment obligation through settlement when the shares are issued in the future, they are accounted for separately under accruals and deferred income (DAS 240.210).

Examples of such obligations to issue shares in the future are options and warrants. If the NV or BV fulfils such an obligation (and therefore issues the shares), the amounts received, which have been recognised in Other reserves, can be transferred to the item share premium. As soon as the granted rights to subscribe to or acquire shares can no longer be exercised, the amounts recognised in this respect under accruals and deferred income are transferred (directly) to Other reserves.

Example: Issue of warrants

On 1 January year 1, a company issues a warrant to its shareholders for each issued share, for which the shareholders pay a premium equal to the fair value at the time of issue. This premium amounts to 1 per warrant. The exercise price is 10 per share and the exercise period is between 1 October and 31 December of year 1. The (possible) payment of this exercise price also fulfils the legal obligation to pay up the shares. One warrant entitles you to one share upon exercise. 1 million shares have been issued on 1 January, so the company receives a total premium of 1 million.

On 1 January year 1, the proceeds of the warrants will be added to the Other reserves. Now suppose that before 31 December year 1 all warrants have been exercised at the prevailing exercise price of 10 per share. The company will then have issued 1 million shares (assume it has newly issued them) and received 10 million in issue proceeds in return. The nominal amount per share is 0.10. The total proceed of 11 million (= 10 + 1) is now classified in equity as follows:

Issued share capital	100,000 (= 1,000,000 shares * 0.10 per share).
Share premium reserve	10,900,000 (= 11,000,000 total received – 100,000 nominal share capital) (of which the proceeds of the warrants of 1,000,000 is transferred from the Other reserves and 9,900,000 comes from the issue of the new shares upon exercise of the warrants).

14.3.5 Repurchase of own shares (share buybacks)

With regard to share buybacks, the law contains special rules, which differ slightly for BVs (Articles 2:207 to 207d NCC) compared to NVs (Articles 2:98 to 98d NCC). Own shares means shares in the share capital of the entity repurchased or otherwise acquired by the entity or subsidiary of the entity for its own account, including depository receipts for such shares.

Distinction between repurchase of own shares and cancellation
A distinction should be made between repurchased shares and shares that are repurchased and subsequently cancelled. After shares have been repurchased, a separate decision should be taken to cancel them. Therefore, if this has not happened, the repurchased shares are still issued. Wrongly, this distinction is not always made in practice. The recognition of share capital reduction by cancellation is described in paragraph 14.3.3.

Recognition of repurchase of own shares
By law, the share capital of an NV or BV may not be reduced by the amount of its own shares or depository receipts for such shares held by the entity or a subsidiary itself (Article 2:373(3) NCC). Such own shares repurchased, or acquired by universal title, may also not be capitalised on the debit side of the balance sheet (Article 2:385(5) NCC). The purchase cost (including transaction costs) of the repurchased own shares must be deducted in full from equity. This can be deducted from Other reserves (DAS 240.214), but the law also permits it to be deducted from other free reserves, provided the articles of association allow this. If there are insufficient free reserves then the 'deficit' is charged to Other reserves. These may show a negative amount as a result (DAS 240.214).

Notes on repurchased own shares
The notes will disclose the item of equity from which the repurchased own shares have been deducted (Article 2:378(2) closing sentence NCC).

An NV must also disclose in the notes when repurchasing its own shares the reason for acquisition, number, nominal amount and agreed price of its own shares and/or depository receipts (Article 2:378(3) NCC). In practice, a repurchase of own shares is usually followed by their cancellation. An NV must also disclose details of the number, type and nominal amount of its own shares or depository receipts for such shares (Article 2:378(4) NCC):

- which the NV itself, or a third party for its account, holds in pledge on the reporting date;
- which the NV itself or a subsidiary holds on the reporting date due to an acquisition (for possible later issue to staff) as part of an employee share scheme.

Sale of own shares held
If own shares held or caused to be held by the entity or a subsidiary are transferred to third parties, the proceeds are credited directly to equity. The proceeds should be credited to the reserve from which the repurchase of these own shares was previously deducted (DAS 240.215).

14.3.6 Share premium

Term
Share premium can be created in several ways. Formally, share premium refers to everything (the amount) paid up above par (above face value) on shares. Share premium can consist entirely or partly of tax-free (tax recognised) share premium. In the Netherlands, share premium is freely distributable. Share premium can also be converted into share capital. In some other countries, share premium is not distributable.

Informal capital contributions
All capital contributions which, by virtue of the NV or BV's financial relationship with its shareholders as such, are made by existing shareholders without the issue of shares or the issue of rights to take or acquire shares (of the NV or BV), are accounted for as share premium. Such capital contributions are not recognised as such in the law, and are therefore also referred to as informal capital contributions. Examples include: the settlement of losses or the waiver of a loan by the shareholder (DAS 240.221).

Taxable share premium
The notes quantify which part of the share premium is not classified as paid-up for tax purposes. A corresponding disclosure is made of the portion of paid-up and called-up share capital not recognised as paid-up for tax purposes (DAS 240.218). Both in situations where shares have been paid up and in situations where shares have not yet been fully paid up but a payment has been called up (Article 2:373(2) NCC), this quantification in the notes enables the user of the financial statements to derive the share premium recognised for tax purposes.

Costs arising from a transaction in own shares
Costs arising from a transaction in own shares are those costs incurred in connection with the issue or purchase of equity instruments that are directly related to that transaction and that would not have been incurred in the absence of the transaction (DAS 240.0). Such a transaction does not include the issue of shares in connection with an acquisition (see Chapter 31) or the purchase or issue of shares in connection with employee benefits (see Chapter 18).

The NV or BV may incur costs in connection with the placement of shares, for example legal advisory fees, civil-law notary fees and communication costs. Under Article 2:365(1) NCC, capitalisation of these costs under intangible fixed assets is permitted. However, according to the Dutch Accounting Standards Board, the costs of establishment and issuing share capital do not meet the criteria for inclusion of intangible fixed assets on the balance sheet. Therefore, it is recommended that these costs not be capitalised (DAS 210.103). If the costs and capital duty associated with the placement of shares are not capitalised, they are charged directly to share premium, net of any tax effect. If and to the extent that share premium is insufficient, it will be recognised and charged to Other reserves. Costs arising from a share placement transaction that ultimately did not go ahead during the financial year are charged directly to profit or loss. Costs related to the placement of shares refer only to those costs directly related to the placement of the shares. Costs arising from transactions giving rise to share placements, such as merger and integration costs, are not part of the costs associated with the placement of shares (DAS 240.219).

14.3.7 Revaluation reserve

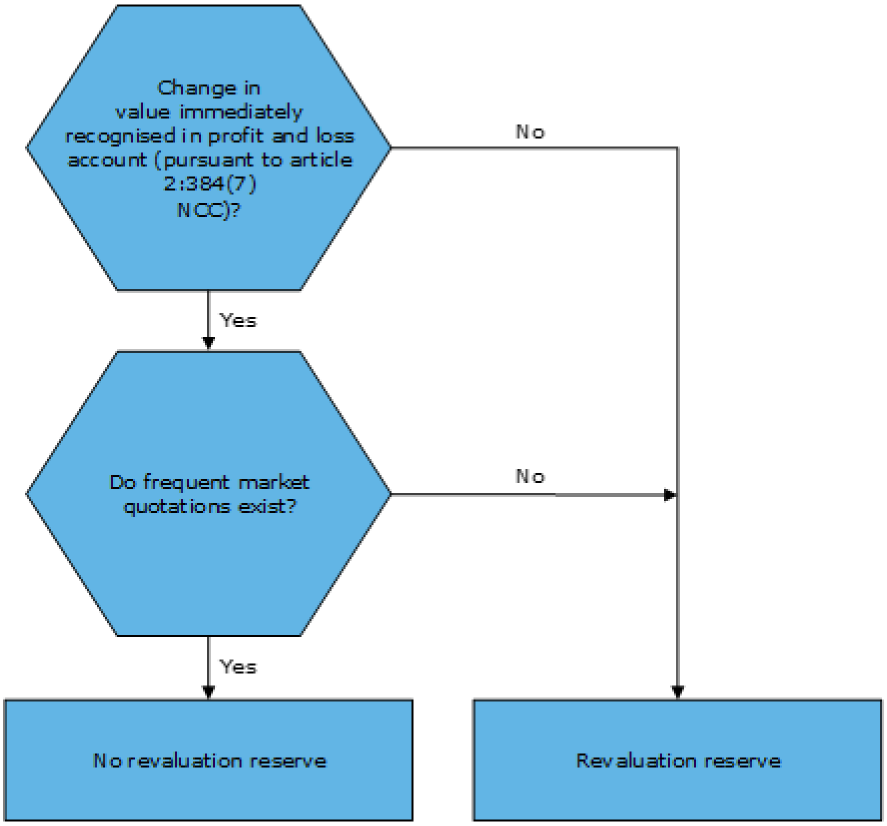
14.3.7.1 Introduction

The revaluation reserve is a legal reserve. Increases in value of tangible and intangible assets measured at current value are recognised in a revaluation reserve pursuant to Article 2:390(1) NCC. This concerns assets that are measured at current value and for which the entity uses an accounting policy in which value increases are not immediately recognised as income. For financial instruments, other investments and agricultural inventory for which there are frequent market quotations, Article 2:384(7) NCC permits accrued value increases when measured at current value to be recognised immediately in the profit and loss account. If no frequent market quotations exist, a revaluation reserve is then recognised out of the free reserves or the profit or loss for the financial year (Article 2:390(1) NCC). No revaluation reserve is recognised if frequent market quotations do exist for the assets in question. Frequent market quotations exist if assets can be sold immediately at a quoted price in a liquid market (Explanatory Memorandum to Bill 29 737, no. 3, p. 23). According to the Explanatory Memorandum to the Decree on current value, a liquid (active) market exists if the assets in question are homogeneous, willing buyers and sellers can be found at any time and the transaction prices are publicly known (DAS 240.224). If assets and liabilities can be sold in a liquid market, the risk that they cannot be sold (or only at a significant discount) is negligible.

If financial instruments, other investments and agricultural inventory for which there are frequent market quotations are valued at current value and the value increases are not recognised immediately in the profit and loss account, but are taken directly to equity, these value increases must be included in a revaluation reserve pursuant to Article 2:390(1) NCC.

The steps to be followed to determine whether a revaluation reserve should be created are mapped in the decision tree below.

Diagram: Creation of revaluation reserve



14.3.7.2 Revaluation reserve for financial instruments at fair value through other comprehensive income

An entity may prepare consolidated financial statements in accordance with IFRS-EU. In that case, the company-only financial statements can be prepared in accordance with Title 9 Book 2 NCC (combination 2), in accordance with Title 9 Book 2 NCC using the measurement principles applied in the consolidated financial statements (combination 3) or in accordance with IFRS-EU (combination 4) (see paragraph 1.2).

Under IFRS-EU, there may be financial assets that are (must or may be) classified in a category whose changes in fair value must be recognised in the consolidated financial statements through other comprehensive income in a separate (revaluation) reserve within equity. These may include both financial assets in the form of debt instruments and equity instruments. This distinction is relevant because the revaluation reserve of financial assets in the form of debt instruments must still be transferred ('recycled') to the profit and loss account when the instruments are sold or impaired. With regard to equity instruments, this does not happen and the changes in value remain within equity, even if the equity instruments are sold. In the latter case, the (positive) revaluation reserve is then transferred to, for example, Other reserves.

As changes in value can be either positive or negative, both revaluation reserves can become negative under IFRS-EU. However, Title 9 Book 2 NCC states that a negative revaluation reserve is not permitted. The question is how a negative revaluation reserve should be presented in the company-only financial statements if the consolidated financial statements are prepared under IFRS-EU and the company-only financial statements under combination 3 or 4.

The Dutch Accounting Standards prescribe the following in this situation (DAS 240.227b):

- an entity applying Title 9 Book 2 NCC in its company-only financial statements (combination 2), recognises the negative amount (the cumulative negative difference between the current value and the cost of the financial asset) through the profit and loss account pursuant to Article 2:390 (3) NCC;
- an entity applying combination 3 or 4, presents, in respect of financial assets in the form of debt instruments, the negative amount as a negative revaluation reserve (unless it is impaired). It should be disclosed in the notes that for the purpose of determining the freely distributable profit, this negative revaluation reserve is deducted from the freely distributable reserves; and
- an entity applying combination 3 or 4, in respect of financial assets in the form of equity instruments, deducts the negative amount directly from freely distributable reserves.

These provisions should be expressly considered in the context of capital protection. If IFRS-EU is applied, Other reserves may be higher than if Title 9 Book 2 NCC is applied (if a negative revaluation reserve is presented). On the other hand, if IFRS-EU is applied, negative balances of legal reserves should be deducted from other free reserves to determine the freely distributable availability. There is therefore only a difference in presentation under equity. Thus, these three recognition methods do not result in a different distributable amount. It should be disclosed in the notes that for the purpose of determining the freely distributable profit, the negative revaluation reserve is deducted from the freely distributable reserves.

14.3.7.3 Deemed cost and revaluation reserve

An entity has the option, on transition to IFRS-EU, to designate the fair value of tangible fixed assets and certain intangible fixed assets as 'deemed cost' on the date of transition to IFRS-EU. The difference from the last carrying amount under 'NL GAAP' should be recognised in retained earnings in the consolidated financial statements. The question is how the measurement difference should be recognised under equity in the company-only financial statements. Under Article 2:390(1) NCC, a revaluation reserve must be recognised for value increases of tangible and intangible assets. The recognition of a revaluation reserve is therefore not related to the application of the current value accounting policy, but to increases in value compared to cost. This means that, in principle, a revaluation reserve must be recognised for a value increase resulting from a deemed cost measurement in the company-only financial statements (DAS 240.224a). This revaluation reserve is released – to free reserves – as the asset is depreciated and/or sold and proportionate to this.

14.3.7.4 OTC derivatives and the revaluation reserve

A key question is whether a revaluation reserve should be recognised for the value increase of an over-the-counter (OTC) derivative (e.g. forward foreign exchange contract or interest rate swap). Entities (financial institutions as well as non-financial institutions) use OTC derivatives, such as interest rate swaps, cross-currency swaps and forward foreign exchange contracts, to hedge interest rate and currency risks. A number of companies choose to measure these OTC derivatives at current value. Based on Article 2:384(7) NCC, the changes in value of such derivative financial instruments may be recognised immediately in profit or loss on application of current value. The question now is whether a revaluation reserve should be created for the positive changes in value of the OTC derivatives that have been credited to profit or loss.

If an entity makes use of OTC derivatives measured at current value, but does not use them for fair value hedges, and recognises the changes in value of these derivatives directly in profit or loss, the following applies (Article 2:390(1) NCC and DAS 240.224b):

- a revaluation reserve should be recognised for value increases of OTC derivatives for which no frequent market quotation is available; and
- no revaluation reserve is recognised for value increases of OTC derivatives, for which frequent market quotations are available.

If an entity makes use of OTC derivatives measured at current value for fair value hedges for which no frequent market quotation is available, and recognises the changes in value of these derivatives directly in profit or loss, the following applies (DAS 240.224b):

- if fair value hedge accounting is used, no revaluation reserve needs to be recognised for value increases, if and to the extent that the position is effectively hedged on balance;

- in respect of these fair value hedges, hedge accounting is not required in all cases. This is not necessary if, when applying the general accounting rules, the changes in value of the related positions are recognised in the profit and loss account (so that there is no accounting mismatch and therefore no need to apply hedge accounting). However, where the balance of changes in value recognised in the profit and loss account is positive, a revaluation reserve is recognised for the positive balance.

If an entity makes use of OTC derivatives measured at current value for fair value hedges for which frequent market quotations are available, no revaluation reserve is recognised.

The Dutch Accounting Standards do not address the other category of derivatives: the exchange traded derivatives (ETDs). The difference is that frequent market quotations will generally be present for ETDs, so no revaluation reserve is recognised. We would point out, though, that not all markets on which ETDs are traded are equally active, evidenced by, for example, a 'high bid-ask spread'. We would point out that a frequent market quotation can only be said to exist if assets can be sold immediately at a quoted price on a liquid market (Explanatory Memorandum to Bill 29 737, no. 3, p. 23). If not, the above fair value hedge provisions also apply to ETDs.

14.3.7.5 Determining revaluation reserve for cash flow hedges

The Dutch Accounting Standards Board states that with regard to cash flow hedges, there are several interpretations on the answer to the question of whether a revaluation reserve should be determined on an individual basis or on a collective basis (DAS 240.227a). This choice affects the size of the distributable reserves. These are cash flow hedges to which cash flow hedge accounting is applied as described in paragraph 21.7.4.2 where, in respect of the effective part, changes in the value of hedge instruments are recognised in equity (revaluation reserve).

A view that the revaluation reserve for cash flow hedges should be considered on a transaction-by-transaction basis implies that for cash flow hedges with a positive fair value, a revaluation reserve should be recognised and for cash flow hedges with a negative value, free reserves up to that amount are not distributable. Since Article 2:384(8) NCC does not contain an explicit provision regarding the netting of this item, it can be concluded on the basis of Article 2:390(3) NCC that this must be done on an individual basis.

Another view is that a collective approach in the recognition of the revaluation reserve on cash flow hedges is possible, provided the maturity dates of the positions to be distinguished are considered. If deferred losses are to be recognised later than deferred profits, a collective approach to deferral with a negative balance would result in free reserves being blocked for too low an amount. If the deferred profits or losses are taken to profit or loss in the same period, there is no impediment to a netted block of free reserves. In support of this view, it is noted that the collective approach to cash flow hedges leads to the same amount of distributable reserves as if hedge instruments (derivatives) are measured at cost, which is an acceptable alternative under Title 9 Book 2 NCC.

The amount of deferred losses charged to the revaluation reserve in cash flow hedges thus depends on the choice between the individual approach and the collective approach and affects distributable reserves (Article 2:390(1) NCC).

Example: Determining the revaluation reserve for cash flow hedges (1)

Public limited liability entity X has a share capital of 100. Other reserves are 200 at the end of the financial year and are distributable. The company applies cash flow hedge accounting to two cash flow hedges. To this end, two derivatives (A and B) were purchased and designated as hedging instruments. At year-end, the value development of hedging instrument A is 100 positive and the value development of hedging instrument B is 50 negative. The following illustrates the impact on distributable reserves of choosing to create a revaluation reserve on an individual basis or on a collective basis.

	Value increase of hedging instrument A	Value decrease of hedging instrument B	Revaluation reserve
Individual basis	100	(50)	100
Collective basis	100	(50)	50

When the revaluation reserve for cash flow hedges is recognised on an individual basis, the value decrease of hedging instrument B (= 50) results in a restriction of distributability by an amount equal to 50 (deferred loss on hedging instrument B). The distributable reserves are then 150 (= 200 - 50).

When the revaluation reserve for cash flow hedges is recognised on a collective basis, the value decrease of hedging instrument B (= 50) is deducted from the value increase of hedging instrument A (= 100). The distributable reserves are then 200 (= 200 - 0).

Example: Determining the revaluation reserve for cash flow hedges (2)

Public limited liability entity X has a share capital of 100. Other reserves are 200 at the end of the financial year and are distributable. The company applies cash flow hedge accounting to two cash flow hedges. To this end, two derivatives (A and B) were purchased and designated as hedging instruments. At year-end, the value development of hedging instrument A is 100 positive and the value development of hedging instrument B is 150 negative. The following illustrates the impact on distributable reserves of choosing to recognise a revaluation reserve on an individual basis or on a collective basis.

	Value increase of hedging instrument A	Value decrease of hedging instrument B	Revaluation reserve
Individual basis	100	(150)	100
Collective basis	100	(150)	(50)

When the revaluation reserve for cash flow hedges is recognised on an individual basis, the value decrease of hedging instrument B (= 150) results in a restriction of distributability by an amount equal to 150 (deferred loss on hedging instrument B). The distributable reserves are then 50 (= 200 - 150).

When the revaluation reserve for cash flow hedges is recognised on a collective basis, the value decrease of hedging instrument B (= 150) is deducted from the value increase of hedging instrument A (= 100). The distributable reserves are then 150 (= 200 - 50).

Thus, different interpretations of the legal provisions appear to be defensible. The Dutch Accounting Standards Board therefore stipulates that, in the case of cash flow hedges, an entity should weigh up the choice to recognise a revaluation reserve on an individual basis or on a collective basis, based on relevant arguments. If the choice is made to recognise a revaluation reserve on a collective basis, there should be maturities of the distinguishable positions in the same reporting period. The notes should explain the choice (DAS 240.227a).

When the revaluation reserve is determined on a collective basis, this may mean that the revaluation reserve for cash flow hedges becomes negative. Under Article 2:390(1) NCC, we believe this is permissible. Indeed, the fifth sentence of Article 2:390(1) NCC stipulates that 'In the amount of deferred losses on financial instruments charged to the revaluation reserve as referred to in Article 2:384(8) NCC (application of cash flow hedge accounting), no distributions may be made from the Other reserves'. If a deferred loss on a hedging instrument in cash flow hedges were not allowed to be charged (temporarily) to equity, but had to be charged directly to profit or loss, a mismatch would arise between the profit or loss on the hedged item and the profit or loss on the hedging instrument.

When the revaluation reserve is recognised on an individual basis, we consider it appropriate to deduct the amount of deferred losses on cash flow hedges from Other reserves.

14.3.7.6 Deferred tax liabilities and revaluation reserve

The last sentence of Article 2:390(1) NCC provides that the revaluation reserve may be reduced by deferred tax liabilities relating to assets measured at a higher amount. Recognising a deferred tax liability in conjunction with a revaluation is not required by law. However, the recognition of a deferred tax liability is strongly preferred (DAS 272.304). Application of this recommendation means that the size of the gross revaluation should be determined as the sum of the revaluation reserve and the liabilities recognised in the provision for deferred taxes in respect of revaluation(s) (DAS 240.225). In other words, effectively the same amount of gross revaluation if the DASB's recommendation is not followed and no deferred tax liability is recognised. This is relevant for recognition of the release of the revaluation reserve. This takes place on the basis of gross revaluation. See also paragraph 14.3.7.11.

On depreciation or after disposal of assets subject to revaluation, the revaluation reserve is reduced by the amount realised. Therefore, the amount included in the revaluation reserve qualifies as a non-distributable reserve.

14.3.7.7 Revaluation reserve reduction due to impairment losses

Asset impairment losses are deducted from the revaluation reserve provided they do not consist of systematic depreciation. If and to the extent that the revaluation reserve is insufficient, the impairment loss is charged to profit or loss (Article 2:387(4) NCC). This loss or its reversal is recognised separately in the profit and loss account or in the notes (DAS 240.226).

14.3.7.8 Asset revaluations at participating interests

On revaluation of a participating interest as a result of asset revaluation at that participating interest, the resulting change in value is moved to the revaluation reserve. Following amendment of Article 2:389(6) NCC in 2005, it is also possible to recognise this movement in the reserve for undistributed profits of participating interests (DAS 240.228). See paragraph 9.2.6 for further explanation of this issue.

14.3.7.9 Recognition of revaluations in the profit and loss account

With regard to the revaluation reserve, the principle is that with the application of current value, the revaluations of the relevant assets are not recognised as income but directly in equity (revaluation reserve). Revaluations are recognised in the profit and loss account only in the following situations (DAS 240.407):

- the revaluation concerns a downward revaluation, if and insofar as a negative amount of the revaluation reserve arises (with the exception of changes in value of financial instruments serving as hedging instruments, for which a negative amount may arise);
- positive revaluation refers to the reversal of an impairment, previously recognised as an expense in profit or loss, to the extent that the carrying amount of the asset before the reversal is below the carrying amount that would have been determined if no impairment had previously been recognised;
- the law or the Dutch Accounting Standards allow recognition in the profit and loss account, if and to the extent that the entity follows that method of recognition (see, for example, Article 2:384(7) NCC).

14.3.7.10 Revaluation reserve for investment properties

For investment properties measured at fair value, a revaluation reserve must be established for the positive difference between fair value and cost. The revaluation reserve is recognised out of the free reserves or the profit for the financial year (Article 2:390(1) NCC). Please refer to paragraph 8.3.4 where we discuss in more detail how the revaluation reserve should be recognised for investment properties.

14.3.7.11 Reduction of revaluation reserve

The revaluation is realised as the relevant assets are depreciated or sold. The way in which the reduction of the revaluation reserve is recognised in appropriate cases depends on the balance sheet measurement and profit determination policies chosen for the financial statements (DAS 240.408).

If a current value system has been chosen where profits and losses are determined according to this system, the realised part of the revaluation reserve is not credited to profit or loss, but to other reserves. If determination of the profit or loss is based on cost, the realised portion of the revaluation reserve is credited to profit or loss. The legislator explains that depending on the method of determining profit or loss, the release of the revaluation reserve is transferred to free reserves or to the profit and loss account (Explanatory Memorandum to draft bill 29 737, no. 3, p. 23). Under a system where the release of the revaluation reserve is credited to the profit and loss account, the costs are recognised on a current value basis and the release is presented separately in the profit and loss account pursuant to Article 2:390(4) NCC. This release should be presented on a separate line in the profit and loss account. This line may not be deducted from operating expenses or added to net margin (DAS 240.411), but must be presented immediately prior to financial income and expenses (as referred to in Article 2:377(3)(k) to (o) and (4)(g) to (k) NCC), as part of the profit or loss before tax (DAS 240.411). Under Article 5(3) of the Decree on annual accounts format (BMJ), a subtotal may be inserted and defined. With the insertion of a subtotal, the profit and loss account shows both the operating profit or loss before the realised revaluation and the operating profit or loss after the realised revaluation.

Obviously, the release of the revaluation reserve cannot be recognised in the profit and loss account if the revaluation (of investment property, for example) has already been recognised in the profit and loss account in the relevant reporting period or in an earlier reporting period. This would result in a value increase being recognised twice in the profit and loss account. This could apply to changes in value of financial instruments, investment property or agricultural inventory for which there are frequent market quotations (Article 2:384(7) NCC). A release of such revaluation reserves should be recognised in Other reserves (DAS 240.411).

If, pursuant to Article 2:390(1) NCC, the revaluation reserve is reduced by deferred tax liabilities in respect of those assets valued at a higher amount, the amount credited to the profit and loss account is determined on a gross basis. The tax amount related to the reduction of the revaluation reserve is charged to profit or loss under the item tax expense relating to income from ordinary operations (DAS 240.411).

14.3.7.12 Presentation of the revaluation reserve

From the wording of Article 2:390 NCC, it can be inferred that the 'revaluation reserve' item must be recognised as a single amount on the credit side of the balance sheet. The Dutch Accounting Standards Board recommends disclosing the different components of the revaluation reserve separately, given the different nature, background and recognition method of the revaluations. Separately, the revaluation reserves can be disclosed for:

- value increase of assets, other than financial instruments, recognised directly in equity (Article 2:390(1), first sentence NCC). This category includes, for example, unrealised value increases of property for own use measured at current value;
- value increases of financial instruments, other than hedging instruments, recognised directly in equity (Article 2:390(1), second sentence NCC). For example, value increases of (unlisted) shares measured at current value, if the choice was made not to recognise them immediately in profit or loss;
- value increases of assets for which changes in value are recognised in profit or loss and for which there are no frequent market quotations (Article 2:390(1), third sentence NCC). Investment properties measured at current value are an example; and
- changes in value of financial instruments serving as hedging instruments in the application of cash flow hedge accounting (Article 2:384(8) NCC).

14.3.8 Other legal reserves

Legal reserves entered in Dutch law through the implementation of the Fourth EC Accounting Directive (now replaced by EU Accounting Directive) and the Second EC Directive on capital protection. Legal reserves are therefore found not only in accounting and reporting rules, but also elsewhere in Book 2 NCC as part of capital protection law. Because legal reserves are mentioned in various places in the Netherlands Civil Code, the law (Article 2:373(4) NCC) includes an exhaustive list of the legal reserves to be recognised. A characteristic of legal reserves is that they belong to the so-called tied capital of the entity. This means that legal reserves are not distributable. It is argued that legal reserves must also be actually paid up (as in the case of issued share capital). However, that is not an accurate statement. Legal reserves must be recognised by law, and this must be reflected on the balance sheet. Subsequently, legal reserves form part of the minimum equity that must be held by the entity, which must be taken into account on the balance sheet test, i.e. in determining whether there is sufficient distributable equity to make distributions to shareholders (see paragraph 14.2).

The revaluation reserve to which the provisions of Article 2:390 NCC apply is a legal reserve. The revaluation reserve is discussed in detail in paragraph 14.3.7. Legal reserves other than the revaluation reserve relate to the following situations (Article 2:373(4) NCC):

- a (negative) euro subscription reserve, arises as a result of the translation of an NV's share capital from guilders to the euro (Article 2:67a(2) NCC);
- a reserve for euro minimum share capital deficit, arises as a result of the translation of an NV's share capital from guilders to the euro (Article 2:67a(3) NCC);

- a reserve for contribution in kind, arising as a result of a contribution (not in cash) for deposit on shares, to an NV without a description being made of what has been contributed or an auditor issuing a certificate in respect thereof (Article 2:94a(3) NCC);
- a reserve for loans to finance the purchase of own shares, arises if an NV makes a loan with a view to taking or acquiring shares, or depository receipts for these, in the share capital of the NV (Article 2:98c(4) NCC);
- a reserve for intangible fixed assets, arises when capitalising costs associated with the incorporation of the BV or NV, the issue of shares or the capitalisation of development costs (Article 2:365(2) NCC);
- a reserve for participating interests, concerning undistributed profits and direct equity increases of participating interests whose distribution (by the participating entity) cannot be effected without restriction (Article 2:389(6) NCC);
- a foreign currency translation reserve, concerning changes in value of participating interests due to the translation of the equity invested in them and the profit or loss from the currency of the participating interest to the currency in which the entity prepares its financial statements (Article 2:389(8) NCC).

Legal reserves are determined individually
A legal reserve should not be determined collectively, but individually (DAS 240.232). The following legal reserves may have a negative balance:

- the legal foreign currency translation reserve (Article 2:389(8) NCC);
- the revaluation reserve on available-for-sale financial instruments when applying combination 3 or 4 in accordance with DAS 100.104;
- the revaluation reserve on cash flow hedge accounting (Article 2:384(8) NCC).

The other legal reserves cannot have a negative balance.

Legal reserve for capitalised development costs
The legal reserve for capitalised development costs should be recognised for development costs capitalised on the balance sheet (Article 2:365(2) NCC). For the criteria and conditions for capitalisation, please refer to Chapter 5. The amount of this reserve at the end of each year is in principle equal to the capitalised amount. In principle, because development costs identified and capitalised in an acquisition (see paragraph 31.3.3) do not give rise to a legal reserve.

Dutch law has no definition of development costs. Alignment can be sought with the definition of development from DAS 210.0. That definition reads: 'The application of knowledge obtained by research or otherwise, leading to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services, prior to the commencement of commercial production or use'. To answer the question of whether a legal reserve should be created, it is irrelevant under which name the costs in question have been capitalised. For example, internally developed (customised) software may meet this definition, but be included on the balance sheet under a separate item 'software'. In that case, too, a legal reserve must be recognised for the capitalised amount. External costs included in an internal development project that meets this definition should also be included in the legal reserve.

Incidentally, this does not mean that a legal reserve for development costs should be recognised for all capitalised software. For example, standard software may be purchased, for which further internal costs are then incurred to set it up for the specific company (to 'tailor' it). These internal costs are not to be considered costs relating to internally generated intangible fixed assets. They are (internal) costs that are part of the cost of the purchased standard software. These internal costs do not meet the definition of 'development costs' as defined above. In that case, therefore, no legal reserve for development costs needs to be recognised.

Another example of internally generated intangible fixed assets for which a legal reserve does not have to be recognised is media productions produced internally by a film production company based on existing technology for the purpose of sale, such as (cinema) films or television programmes. After all, these are not development costs as defined above, either, but relate to commercial production based on existing technology.

Legal reserve for capitalised development costs in connection with received grants
A special situation arises when an entity has received a government grant for capitalised development costs. The question is then for what amount a legal reserve for development costs should be recognised. If the development costs have been capitalised, this grant qualifies as an investment grant which, according to DAS 274, must either be

recognised as an accrued liability on the balance sheet or deducted from the capitalised amount (see paragraph 29.6.2). The latter is not obvious in this situation because, according to Article 2:365(2) NCC, the costs of development must be included separately under intangible fixed assets. Hence, in the following example, the government grant is recognised as an accrued liability.

Example: Legal reserve for capitalised development costs and government grant

An entity has capitalised development costs under intangible fixed assets in the amount of 100. The entity has received a grant for the development costs of 90. This grant is recognised as an accrued liability in accordance with DAS 274.112. What is the amount for which the legal reserve for development costs should now be recognised: 100 or 10 (= 100 - 90)? We have dispensed with tax effects in this example.

We see no objection to including the legal reserve after deducting the accrued liability (i.e. in the amount of 10) in this example. A key reason is that if the development costs were recognised directly in the profit and loss account, the government grant received could be considered an operating grant and would also be recognised directly in the profit and loss account. The distributable equity then decreases net by 10 because the profit is reduced by this amount. In our example, no effect occurs in the profit and loss account, so there is no reduction in equity. From a capital protection point of view, the same situation is achieved by including the legal reserve for 10. It can also be reasoned that an accrued liability will have to be included under non-current debt, increasing equity by 10 on balance through the capitalisation of development costs and with equity having to be restricted by this amount.

Legal reserve for participating interests
The legal reserve for participating interests may arise from the (prescribed) measurement of participating interests using the net asset value method (Article 2:389(6) NCC). The legal reserve for participating interests, which is also discussed in Chapter 9, is recognised in the amount of the share of the (participating) entity in the profits and direct capital increases of the participating interest(s) since the initial measurement of this participating interest at net asset value. Direct equity increases arising from the entity's financial relationship with its participating interest as a shareholder (e.g. an additional share premium payment) are not included in the legal reserve (DAS240.229a). This reserve is reduced by:

- the dividend – from this or these participating interest(s) – to which the (participating) entity was entitled up to the adoption of the financial statements;
- (dividend) distributions, receipt of which by the (participating) entity in the Netherlands can be effected without restrictions, for example through the exercising of a majority of the voting rights in the participating interest's shareholders' meeting; and
- direct equity reductions.

The amount of the legal reserve for participating interests is thus determined as follows:

Share in profits from participating interests since initial measurement	000
Share in direct equity increases in the participating interest since the initial measurement	000
Share in direct equity decreases in the participating interest since the initial measurement	(000)
Distributions to which the entity was entitled from the initial measurement up to the adoption of the financial statements	(000)
Distributions that the entity can effect without restriction	(000)
Legal reserve for participating interests	000

The recognition of this legal reserve prevents the (participating) entity from making a distribution to its shareholders in respect of profits (from the participating interest) that it cannot (yet) dispose of.

Examples of restrictions to effect receipt of (dividend) distributions by the (participating) entity are (DAS 240.229a):

- inability to enforce a distribution decision due to lack of control. This generally applies to minority shareholders;
- a (foreign) participating interest that is restricted by laws and regulations from distributing profits or reserves. Examples include:
    - barriers in foreign payment transactions;

    - currency restrictions;
    - legal reserves to be recognised by the participating interest;
    - a participating interest that is restricted in making distributions because otherwise continuity is no longer guaranteed. This is the case if discontinuity of the participating interest is unavoidable due to distribution or if serious uncertainty about going concern arises (see paragraph 2.12 and paragraph 14.2.3 on the distribution test);
    - restrictions arising from contractual provisions, for example if it has been agreed with the banker to hold a certain minimum level of equity;
- the additional tax levied on the distributing participating interest when distribution is made.

Example: Determination of legal reserve for participating interests (1)

Holding Entity A has a 100% participating interest in Group Entity G. G is a Dutch BV. The participating interest in G is measured by A in its company-only financial statements at net asset value. At the end of the financial year, G capitalised development costs under intangible fixed assets with a carrying amount of 100. As a result, G has recognised a legal reserve for development costs of 100. For this amount, distribution cannot be effected by A. Otherwise, there are no restrictions on A's being able to effect distribution. Since A acquired G, G's profit has been 500 and it has not distributed any dividends. There have also been no direct equity movements.

Holding Entity A recognises a legal reserve for participating interests in the amount of 100 for its participating interest in G.

Legal reserve for participating interests on an individual basis
The legal reserve for participating interests must be determined on an individual basis, i.e. for each individual participating interest. Indeed, the first sentence of Article 2:389(6) NCC states that the entity must recognise a reserve equal to its share in the profit from participating interests and in the direct capital increases since the initial measurement in accordance with paragraph 3. Based on this provision, the Dutch Accounting Standards Board concludes that the legal reserve for participating interests should be determined on an individual basis (DAS 240.232a).

Example: Determination of legal reserve for participating interests (2)

Private limited liability entity A holds two 40% interests in B and C. These participating interests were established by A in the past, with A paying up the issued share capital of these participating interests in full. A, as a minority shareholder of B and C, cannot effect receipt of (dividend) distributions without restrictions. The participating interests apply the same accounting principles as A. The financial statements of B and C show the following at reporting date:

	Share capital	Cumulative profit including direct equity movements
B	100	500
C	100	(300)

A should recognise a legal reserve for participating interests in the amount of 200 (= 40% of 500). Participating interest C is therefore not included in the determination of the amount of the legal reserve for participating interests, as the cumulative profits including direct movements in equity since establishment is negative.

Legal reserve for participating interests to be held by majority shareholder
As mentioned, the legal reserve for participating interests is reduced by (dividend) distributions that the (participating) entity can effect without restrictions. Usually, by exercising a majority of the voting rights in the shareholders' meeting of the participating interest, a majority shareholder can effect a distribution up to the amount of the so-called tied capital of the participating interest. In a BV, the legal and statutory reserves constitute the tied capital. In an NV, this also includes the issued share capital.

However, there may be situations where a majority shareholder is also restricted in being able to effect distributions for (part of) the non-tied capital. See the examples described above in this paragraph, which are included in DAS 240.229a.

Example: Determination of legal reserve for participating interests (3)

Private limited liability entity A holds two 80% interests in B and C. These participating interests were established by A in the past, with A paying up the issued share capital of these participating interests in full. A, as the majority shareholder of B and C, can effect receipt of (dividend) distributions without restrictions. The participating interests apply the same accounting principles as A. The financial statements of B and C show the following at reporting date:

	Share capital	Cumulative profit including direct equity movements
B	100	500
C	100	(300)

B recognised a revaluation reserve relating to its head office of 100 at reporting date. A should recognise a legal reserve for participating interests in the amount of 80 (= 80% of 100) because B's distributable capital is 400 (= 500-100) and therefore 100 cannot be distributed without restriction. A's share in this is 80. Participating interest C is not included in the determination of the amount of the legal reserve for participating interests, as the cumulative profit including direct movements in equity since establishment is negative.

Example: Determination of legal reserve for participating interests (4)

Distributions by a BV require the approval of the management board. Directors must refuse approval if they know or should reasonably understand at the time of the distribution that the company cannot continue to pay its due debt after the proposed distribution. Directors will have to carry out an assessment for this purpose, known as the distribution test (see also paragraph 14.2.3). In many cases, conducting that distribution test will not be complicated. In other cases, a more or less detailed cash flow forecast will have to be prepared with corresponding balance sheet projections, with the resulting borrowing requirement being checked against the available credit availability. Because directors will (have to) refuse approval if a BV becomes insolvent due to distributions, it is established in principle that there is a certain limit to the amount that can be distributed.

The distribution test has a clear relationship with the going concern issue. This is because, if, even after making a distribution, there is no uncertainty about the continuance as a going concern (see paragraph 2.12), it can be concluded that the entity can 'continue to pay its due debt'.

If the majority shareholder (and parent entity) can avoid insolvency of the participating interest and is also willing to do so, board approval can be effectively enforced and distribution can be effected without restriction. However, if the majority shareholder is in bad shape and effectively has no ability to support the participating interest, there may be a restriction to effecting distribution. In that case, in our view, shareholders are restricted in the distribution to 'the amount, taking into account all relevant circumstances, that is not expected to lead to insolvency of the participating interest within the foreseeable future'. The question here is whether a shareholder has the information to determine that amount. Normally, this will be the case in group relationships. Just as the parent entity can obtain information to determine the net asset value of a subsidiary, it will normally also be able to obtain the information needed to determine the amount to which the subsidiary is restricted in distributions. The parent entity will simply be able to request that information from the subsidiary's management board.

Determining the amount of the legal reserve for participating interests will have its issues in practice. Indeed, it will often not be possible to determine an exact limit amount, but at best a certain range. Then the question is what amount within that range should be taken into account when determining the amount of the legal reserve for participating interests. For example, a distribution of 100,000 may not be expected to result in insolvency, but a distribution of 150,000 almost certainly will. The legal reserve for participating interests will then be based on a limit between those two amounts. The question is, however, what can you predict about a distribution that lies between those two amounts? In our view, the best possible estimate should be made based on the specific circumstances.

Incidentally, it should be remembered that the amount of the legal reserves is only relevant for the balance sheet test that the parent entity must carry out on its own (proposed) distributions. It is not relevant to the distribution test that the parent entity must also carry out.

Legal foreign currency translation reserve
Article 2:389(8) NCC provides that a foreign currency translation reserve must be recognised for differences resulting from translating the capital invested in a foreign participating interest and the profit or loss from the functional (foreign) currency of this participating interest to the presentation currency of the participating entity (see paragraph 4.4). No distributions can be made from reserves in the amount of the (negative or positive) balance of the foreign currency translation reserve. Invested capital also includes loans granted to participating interests to the extent that they are in substance an extension or contraction of the net investment. Furthermore, Article 2:389(8) NCC stipulates that exchange rate differences on loans taken out to cover the foreign exchange risk of foreign participating interests are also credited or charged to this reserve. When a foreign participating interest is disposed of, the cumulative translation differences at the time of disposal are recognised in the profit and loss account as part of the gain or loss on disposal. A foreign currency translation reserve is then no longer held (DAS 122.311).

Pursuant to Article 2:373(4) NCC, the foreign currency translation reserve (created pursuant to Article 2:373(4) NCC) is included in equity under the other legal reserves. The Dutch Accounting Standards Board recommends presenting the foreign currency translation reserve as a separate item on the balance sheet under equity. The alternative is to include the foreign currency translation reserve in the notes as a breakdown of the item other legal reserves under equity on the balance sheet.

Recognition and release of legal reserves
The legal reserves are recognised out of the free reserves, share premium or profit for the financial year. This is at the discretion of the competent bodies of the entity in compliance with the legal and statutory provisions on reserve recognition. The reduction in legal reserves is taken to Other reserves. Reductions in the revaluation reserve can also be taken to the profit and loss account, these are then included in a separate item. Again, this is at the discretion of the competent bodies of the entity, in compliance with legal and statutory provisions.

The prepared balance sheet should recognise the movements that should be made to the reserves under legal and statutory provisions. The proposal for the appropriation of the release from or for the source of the addition to the legal and statutory reserves is included under Other information (DAS 240.231) to the extent necessary for the required insight. If the amount of the legal reserves to be recognised exceeds the total amount of reserves available, the difference is charged to Other reserves. This then results in the legal reserves having the amount to be recognised and Other reserves showing a negative amount (DAS 240.230).

Presentation of other legal reserves
Other legal reserves must be distinguished by type (Article 2:373(1) NCC). To this end, they are presented on the balance sheet either as separate items of equity or as a total item other legal reserves, with a breakdown in the notes. Presenting them as separate items on the balance sheet is preferred by the Dutch Accounting Standards Board (DAS 240.229).

14.3.9 Statutory reserves

Statutory reserves are reserves that must be recognised pursuant to the articles of association. Such statutory reserves are not distributable until the articles of association are amended. With any such amendment to the articles of association, the reason for recognising the statutory reserve disappears. A reserve thus lifted by an amendment to the articles of association may be added to Other reserves or freely distributable reserves. If the amount of statutory reserves to be recognised exceeds the total amount of reserves, the difference is charged to Other reserves. This then results in the statutory reserves having the amount to be recognised and the Other reserves showing a negative amount (DAS 240.233).

14.3.10 Other reserves

Other reserves can take many forms. Perhaps the most familiar form is the general (profit) reserve or dividend reserve(s), created for the benefit of specific shareholders or holders of alphabet shares, for example. Briefly, Other reserves are all reserves other than the legal and statutory reserves (DAS 240.234). Other reserves are freely distributable to shareholders. An accumulated loss for previous financial years is deducted from the item 'undistributed profit' or deducted from Other reserves. If the loss for the financial year exceeds the amount of Other reserves and undistributed profit, this results in the Other reserves showing a negative amount (DAS 240.235).

14.3.11 Undistributed profit

The last item of equity concerns undistributed profits. Thereby, the profit or loss after tax for the financial year must be disclosed separately, insofar as its appropriation is not included on the balance sheet (Article 2:373(1)(g) NCC). Here, the legislator apparently assumed that undistributed profit from a previous financial year can be included under this item, although it will usually have been added to Other reserves. It is up to the shareholders to appropriate (distribute) the undistributed profit. As long as no resolution to add to Other reserves (or to distribute) has been passed by the shareholders, the profit should be recognised under this undistributed profits item. The balance sheet may reflect equity, taking into account the appropriation of profit or loss or the proposal to do so (Article 2:362(2) NCC). The Decree on annual accounts format prescribes that, at the top of the balance sheet, it must be clear whether or not the balance sheet includes the appropriation of the profit or loss. If the appropriation of profit or loss is not reflected on the balance sheet, the profit or loss after tax is disclosed separately as part of the undistributed profits item (Article 2:373(1)(g) NCC).

Recognition of distributable dividend
Normally, the distributable dividend is determined after the reporting date (when the financial statements are adopted). When that is the case, the entity should (DAS 160.208):

- not recognise the proposed amount of dividend distributions separately on the balance sheet; in that case, the profit or loss for the financial year is included as a separate item in equity (Article 2:373(1) NCC), with the proposed amount of dividend distribution being disclosed in the notes (Article 2:380c NCC);
- recognise the proposed amount of dividend distributions on the balance sheet as a separate component of equity; or
- recognise the proposed amount of dividend distributions on the balance sheet under liabilities.

In the first case, a balance sheet is prepared before profit appropriation. In the second and third cases, a balance sheet is prepared after profit appropriation. Similarly, if there is a loss for the financial year or in the case of negative Other reserves, a balance sheet can be prepared before recognition of the profit or loss. In this situation, the profit or loss for the financial year is recognised separately within equity (Article 2:373(1) NCC).

Preference dividend recognition
Preference dividend should be recognised as a liability at reporting date if, based on statutory provisions, preference dividend *should* be paid where there is sufficient freely distributable equity (DAS 160.209).

This applies irrespective of whether the balance sheet has been prepared before or after profit appropriation and irrespective of the classification of preference share capital as equity or liabilities as described above in paragraph 14.1 (as regards the option in the company-only financial statements) and in paragraph 21.6.

If it involves a BV whose management board has not approved the distribution of preference dividend, the absence of such approval is disclosed in the notes (DAS 160.209).

If the balance sheet is prepared before profit appropriation, the amount to be paid out as preference dividend is deducted from the profit or loss after tax for the financial year. This happens visibly on the balance sheet itself. The balance of profit or loss for the financial year less preference dividends is then referred to as undistributed profit (DAS 160.209).

Example: Balance sheet before and after profit appropriation and recognition of preference dividend

An entity has preference share capital in addition to ordinary share capital. Statutory provisions state that if there is sufficient profit, a total of 700 will be distributed on preference shares. The dividend proposal in respect of the ordinary shares is 1,000. In addition, 600 should be added to the legal reserves. The following details are also known at the end of the financial year:

Ordinary share capital	18,000
Preference share capital	10,000
Other reserves	500
Profit after tax for the financial year	3,000
	31,500

Balance sheet before profit appropriation

If the balance sheet is prepared before profit appropriation, the dividend proposal relating to the ordinary shares is not recognised. However, a liability of 700 is recognised for the preference dividend.

In addition, 600 is added to the legal reserves. The decision was taken to recognise this legal reserve out of the profit appropriation. Both the preference dividend and the addition to the legal reserve are presented separately as negative items. The composition of equity is then as follows:

Ordinary share capital		18,000
Preference share capital		10,000
Legal reserves		600
Other reserves		500
Profit after tax for the financial year	3,000	
Preference dividend	(700)	
Addition to legal reserve	(600)	
Undistributed profit		1,700
Equity		30,800
Liability for distribution preference dividend		700
Total		31,500

Balance sheet after profit appropriation

If the balance sheet is prepared after profit appropriation, the dividend proposal in respect of the ordinary shares will be recognised. This means that the total liability on distributable dividends is 1,700. Incidentally, recognising the proposed amount of dividend distributions on the balance sheet as a separate item of equity is permitted (DAS 160.208). In addition, 600 is added to the legal reserves. Both the preference dividend and the addition to the legal reserves are charged to Other reserves. The composition of equity is then as follows:

Ordinary share capital	18,000
Preference share capital	10,000
Legal reserves	600
Other reserves (= 500 - 700 - 600 + 3,000 - 1,000)	1,200
Equity	29,800
Liability for dividend distribution on ordinary shares	1,000
Liability for distribution preference dividend	700
Total	31,500

If the financial statements show that there is insufficient freely distributable equity, and if in future years the cumulative preference dividend will have to be distributed once there is sufficient freely distributable equity, the amount that will then be payable should be disclosed in the notes (DAS 160.209). Also, according to this paragraph, if preference share capital is presented as a liability, the cumulative preference dividend payable at that time should be included in non-current liabilities.

Recognition of interim dividend

Any interim distribution (interim dividend) is only possible in an NV if the articles of association allow it and there is sufficient free availability in equity (Article 2:105(4) NCC). For a BV, the law stipulates that distributions – including interim distributions – are possible insofar as equity exceeds the legal and statutory reserves (Article 2:216(1) NCC). Of course, in the latter case, the other provisions of Article 2:216 NCC, such as the distribution test, must also be met.

An interim dividend has been distributed if, on the basis of a resolution of the body designated for that purpose in the entity's articles of association, a distribution has been made, during the reporting period, out of the profit or loss for the financial year, as part of and in anticipation of the profit appropriation.

If an interim dividend has been distributed, then on the balance sheet before profit appropriation the distributed interim dividend is deducted from the profit or loss after tax for the financial year, the balance being referred to as undistributed profit. This is done visibly on the balance sheet (DAS 160.210).

14.4 Direct movements in equity

There is little in the law specifically regulating direct movements in equity. Partly for this reason, the Dutch Accounting Standards Board has included standards on direct movements in equity. The essence of these is that, almost exclusively, movements in equity that relate to the entity's direct financial relationship with its shareholders (or members) and movements in legal reserves are recognised directly in equity. Almost all other movements in equity are recognised in the profit and loss account. In determining the amounts to be credited or charged directly to equity, account is taken of related changes in tax payable or in the provision for deferred taxes, respectively. These changes should also be credited or charged directly to equity (DAS 240.402).

Examples of direct equity movements
Examples of equity movements that concern the entity's financial relationship with its shareholders (members) as such and that are recognised directly in equity are (DAS 240.403):

- equity increase through share placements, informal capital contributions, settlement of losses (including waiver of debt) or sale of previously repurchased own shares;
- equity decrease through repurchase of or repayment on shares;
- equity increase or decrease resulting from the translation of share capital in financial statements denominated in a foreign currency unit;
- movements within equity as a result of a reduction of the nominal amount of shares;
- dividend distribution charged to free reserves;
- informal capital withdrawals.

The effects of changes in accounting policies are also recognised directly in equity (DAS 140.209). The same applies to recognition of the correction of material errors (DAS 150.202).

Foreign currency translation differences are – under certain circumstances – recognised directly in equity (see Chapter 4).

Informal capital withdrawals
In certain situations, based on economic reality, there are informal capital withdrawals, without legal qualification as, for example, profit distribution or share capital reduction. In practice, for example, it regularly happens that the director-major shareholder of a family-owned company makes cash withdrawals from their Onderneming-BV. The question is how such withdrawals should (or could) be recognised in the financial statements of Onderneming-BV. What aspects play a role? The example below is a simplified representation of a real-life case taken from tax case law.

Example: Informal capital withdrawals

A director-major shareholder has a current account debt (CA debt) with its holding entity Onderneming-BV. This debt increased by over 1 million during the period from 1 January 2011 to 1 January 2020. The director-major shareholder and its private limited liability entity have not agreed on any loan terms or security. The director-major shareholder uses the money withdrawn from the CA debt for living expenses and paying tax debt. Apart from taxable income from his own home (flat rate), he has no own income from work and home. Also given his small amount of private equity, it is clear that the director-major shareholder cannot fully repay its CA debt.

How should these current account withdrawals be recognised in the financial statements of Onderneming-BV?

In a strictly legal approach, the recognition of withdrawals would follow the legal form. The parties may stipulate that the withdrawals are loans. In a legal sense, this then constitutes a loan. Even if the intention is to start repaying the loan out of future profit distributions (or possibly sales revenue). Following the legal form means that Onderneming-BV includes a receivable from the director-major shareholder on its balance sheet. Profit distributions are only recognised under this approach on the basis of a dividend decision (to be taken in the future).

In that case, however, the CA withdrawals are actually, in economic terms, an advance on future profit distributions. The director-major shareholder does not have enough equity or assets in private and no other sources of income besides income from its own home. Therefore, repayment can only take place through profit distribution or from the revenues from sales. Both situations lead to the conclusion that the current account payments should be seen as informal capital withdrawals or (in tax terms) hidden dividends.

In our view, only the economic approach meets the insight requirement set by the law. Tax case law has also ruled in a similar case that this is a hidden dividend (District Court of Zeeland-West-Brabant 10 July 2020).

In practice, it also happens that relatively small current account balances exist between the entity and the director-major shareholder that become apparent when preparing the balance sheet. As long as these balances have an overflow character and are relatively modest in amount, there is no objection to leaving them on the balance sheet as current account balances.

The Dutch Accounting Standards Board states that 'substance prevails over form' (DAS 110.116): 'For information to faithfully reflect the transactions and events it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality, and not merely their legal form.' In the example included above, if the legal form is followed, equity is overstated. After all, the receivable will only be recoverable from funds of Onderneming-BV. The withdrawals are an equity decrease that relates to the entity's financial relationship with its director-major shareholder in the role of shareholder as such. Such equity movements are recognised directly in equity under DAS 240.403.

Incidentally, the example has other aspects, especially legal and tax. Based on legal provisions, an entity cannot distribute profits without a dividend resolution. It is therefore advisable to formalise capital withdrawals as profit distributions in a dividend resolution. In addition, of course, the tax implications for the company must also be reflected in the financial statements.

14.5 Disclosure

14.5.1 Disclosure requirements arising from rights granted by the entity to subscribe to or acquire shares

Rights to subscribe to or acquire shares granted by the entity to shareholders or others – conditionally or unconditionally – and outstanding at the end of the financial year (such as options, warrants, conversion rights attached to convertible bonds) should be disclosed in the notes, so that a proper view of them can be formed (DAS 240.238).

For each group of granted rights, the following is disclosed (DAS 240.238):

- the number of share options not yet exercised at the beginning of the financial year;
- the number of share options granted by the company during the financial year with the most important of the conditions attached to them, such as the number of associated shares, the exercise prices and the remaining term; if such conditions are changed during the financial year, these changes should be disclosed separately;
- the number of share options exercised during the financial year, with at least the disclosure of the number of shares corresponding to that exercise, the exercise prices, the market prices at the time of exercise (or the average market prices per share over a specified, short period before that time), and whether own shares were repurchased or new shares were issued for the exercise of those rights; and
- the number of share options not yet exercised at the end of the financial year, with disclosure of:
  - the number of shares or depository receipts, type and nominal amount to which the options granted give entitlement;
  - the exercise price of the granted options;
  - the remaining term of the unexercised options;
  - the principal conditions governing exercise of the options;
  - any financing arrangements made at the time the options were granted; and
  - any other data relevant to assessing the value of the options.

A group of granted rights
A group of granted rights is a collection of rights of equal nature. In determining separately distinguishable groups of granted rights, it is necessary to consider whether the nature of the granted rights is sufficiently similar for recognition as a single group (DAS 240.238).

Hedging policy and position
The entity should also disclose in the notes (DAS 240.239):

- its policy for hedging granted rights to subscribe to or acquire its own shares. This could include buying back own shares, acquiring call options on own shares and issuing new shares;
- the position at reporting date of granted and not yet hedged rights to subscribe to or acquire own shares;
- if at reporting date hedging took place fully or partly by means of the purchase of own shares, acquisition of call options on own shares or a similar transaction, the average prices paid for these.

Obligations to repurchase own shares
If the entity or a subsidiary thereof has undertaken to purchase outstanding shares of the entity or depository receipts for shares, this should be disclosed in the notes, with a mention of the face value of the shares or depository receipts for shares, the agreed price and any other relevant conditions. This provision also applies in respect of an entity or company in which the entity has a participating interest that is not a subsidiary, where the relevant information is known (DAS 240.240). In this regard, the Dutch Accounting Standards Board indicates that obligations to buy outstanding shares may arise from contractual provisions or by writing put options on own shares.

14.5.2 Other disclosure requirements

The notes must include an equity movement schedule which, for each item, breaks down the additions and reductions according to their nature (Article 2:378(1) NCC). In the schedule, the item paid-up and called-up share capital is broken down by type of shares (Article 2:378(2) NCC). The movement schedule should also include the comparative figures for the previous financial year (DAS 240.237). The movement of the (own) shares held or caused to be held by the entity itself (or a subsidiary of the entity) for its own account must also be disclosed, along with the item of equity from which the purchase cost thereof has been deducted (Article 2:378(2) NCC). The manner in which payments were made on shares that became due or were made voluntarily during the financial year is shown (Article 2:378(3) NCC).

If there are differences between equity (and profit) according to the company-only and consolidated financial statements, these must be disclosed in the notes to the company-only financial statements (Article 2:389(10) NCC).

If cumulative preference or similar shares are issued, then if dividends are in arrears, the amount should be disclosed in the notes (DAS 240.241).

Significant movements in equity after the end of the financial year, for example as a result of share issues, are disclosed in the notes (DAS 240.242).

The notes should state:

- appropriation of profit or recognition of loss, or the proposal for this (Article 2:380c NCC); and
- the number of profit certificates and similar rights, with disclosure of the powers they confer (Article 2:380d NCC).

14.6 Exemptions for medium-sized and small entities

Medium-sized entities are exempt from making quantified disclosure in the notes of the portion of the share premium not recognised as paid-up for tax purposes and the portion of paid-up and called-up share capital not recognised as paid-up for tax purposes (DAS 240.218).

Small entities need only include the information required by law in the notes and may consider disclosing additional information (’over and above the legal minimum’) in the notes.

14.7 Significant differences from IFRS

Distinction between equity and liabilities
Under IFRS, the rules for classification of issued financial instruments as equity or liabilities in the company-only financial statements are the same as the classification in the consolidated financial statements. This means that the distinction between equity and liabilities in the company-only financial statements is determined according to the economic reality of the contractual terms. Under DAS 240.207 and 208, the distinction between equity and liabilities in the company-only financial statements can be determined on the basis of the legal form or on the basis of the economic reality of the financial instruments issued. This is a policy choice that should be applied consistently.

Share issue costs
According to IAS 32 'Financial Instruments: Presentation', share issue costs are charged directly to equity. Under Article 2:365 NCC, there is the possibility of capitalising these costs. The Dutch Accounting Standards Board recommends that these costs should not be capitalised but charged to share premium and Other reserves respectively.

Realisation of revaluation reserve
Under IFRS, the realisation of the revaluation reserve on tangible and intangible fixed assets is not allowed to be recognised in the profit and loss account (IAS 16.41, IAS 38.87). Based on Dutch laws and regulations, the recognition of the realised revaluation depends on the chosen objective of the determination of the profit or loss.

Dividend declared after reporting date
In IAS 10 'Events after the reporting period', it is not permitted to recognise the dividend declared after reporting date as liability in the financial statements for the past financial year. The IASB considers such a dividend decision taken after reporting date as an event of the new year that may not be recognised in the financial statements of that current year, being a so-called 'non-adjusting subsequent event'. Pursuant to Article 2:373(1) NCC (DAS 160.208), it is possible, under NL GAAP, to prepare a balance sheet after profit appropriation in which dividend declared after reporting date is recognised as a liability. The recognition under IFRS is also permitted under NL GAAP.

Dividend in kind
Taking into account the previous difference in the timing of the recognition of the dividend liability, declared dividends are recognised as debt under both IFRS and NL GAAP. For dividends paid in non-cash assets (in kind states that such dividend should be measured at the fair value of the assets to be distributed. Subsequently, the dividend liability must be remeasured to fair value at each reporting date with changes in value recognised in shareholders' equity.

On distribution, the difference between the fair value and the carrying amount of the distributed assets is recognised in the profit and loss account.

The Dutch Accounting Standards do not contain specific provisions on this. However, recognition under IFRIC 17 is permitted under NL GAAP.

15 Recognition of intercompany transactions

15.1 Introduction

General
The Dutch Accounting Standards Board has restructured DAS 260 'Recognition of intercompany transactions in financial statements'. The new standard does not propose any substantial changes, but enhances the readability and accessibility. However, a number of points have been clarified; these are indicated in this chapter. These are:

- elimination of losses (paragraph 15.2.7);
- presentation of elimination amounts (paragraph 15.2.5); and
- elimination in case of negative net asset value (paragraph 15.2.8).

The standard is in effect for reporting periods commencing on or after 1 January 2024. This chapter incorporates the new structure of DAS 260.

The new structure is based on the measurement basis of participating interests used:

- participating interests measured in accordance with the net asset value method (paragraph 2); and
- participating interests measured at acquisition cost or current value (paragraph 3).

In addition, the recognition of intercompany transactions in the consolidated financial statements (paragraph 4) and the recognition in the financial statements of the participating interest are discussed separately (paragraph 5).

Intercompany transactions can take place between:

- the entity and a consolidated entity (or group entity);
- the entity and a participating interest of that entity;
- group entities; or
- participating interests of the entity.

In the above listing, the entity can be either top holding entity, intermediate holding entity in the group or any other group entity. Even if an intermediate holding entity does not prepare consolidated financial statements, this chapter applies (DAS 260.102).

In particular, it is discussed whether profit or loss on intercompany transactions can be classified as realised or whether these should be eliminated from the consolidated and/or company-only financial statements. As far as the company-only financial statements is concerned, this is important to determine whether these transactions result in a higher or lower distributable equity (DAS 260.102).

This chapter does not apply to the following intercompany transactions:

- transactions between an entity and an equity interest that qualifies as investment and therefore does not qualify as group entity or participating interest. The profit or loss on such transactions are recognised in full in the consolidated and company-only financial statements (DAS 260.103);
- intercompany services are recognised to the extent that they are not capitalised by the customer company. Revenues from services can usually be considered as directly and fully realised by the service provider as they are normally not capitalised by the customer company but are recognised as costs. In the consolidated financial statements, revenue generated by the service provider is eliminated against the costs recognised by the customer company. However, if and to the extent that service charges are capitalised by the customer company, revenue is eliminated in accordance with this chapter (DAS 260.103).

Types of intercompany transactions
Intercompany transactions can be distinguished as follows (DAS 260.104):

- downstream sales: transfers from the controlling respectively participating entity to a group entity or participating interest;

- upstream sales: transfers from a group entity or participating interest to the controlling respectively participating entity; and
- sidestream sales: transfers between group entities and/or participating interests.

See Annex 1 to this chapter for a diagram showing the recognition of intercompany transactions.

15.2 Intercompany transactions with and between participating interests measured in accordance with the net asset value method

In this paragraph, the recognition of intercompany transactions in the financial statements of the participating entity is explained. It concerns transactions with and between participating interests that are measured in accordance with the net asset value method. These may therefore be transactions involving minority or controlling interests in the company-only financial statements or non-consolidated (minority) interests in the consolidated financial statements.

15.2.1 General

In the measurement of a participating interest according to the net asset value method, the participating interest is considered to be a collection of assets and liabilities and not an indivisible asset. This method of measurement reflects the economic interest of the participating party in this collection of assets and liabilities of the participating interest, including the assets or liabilities transferred by the participating entity to the participating interest (DAS 260.201).

In case of an intercompany transaction, only profit or loss resulting from this transaction is recognised by the participating entity in proportion to the relative interest in the assets or liabilities transferred to third parties (proportional determination of profit or loss). Therefore, no profit or loss resulting from this transfer is recognised in proportion to the relative interest that the participating entity itself has in the transferred assets or liabilities.

The proportional recognition of intercompany profit or loss takes place by eliminating the part of the profit or loss that has not yet been realised. As a result of this elimination, it is possible that a profit or loss from participating interest is recognised in the profit and loss account that deviates from the share in the profit or loss as recognised by the participating interest in its financial statements. Also, the elimination by the participating entity may result in a difference between the measurement of the participating interest according to the financial statements of the participating entity and the participating entity's share in equity according to the financial statements of that participating interest for the amount (cumulatively) eliminated on intercompany transactions at the time of measurement (DAS 260.202).

Example: Difference between the measurement of the participating interest according to the financial statements of the participating entity and the participating entity’s share in equity according to the financial statements of that participating interest (based on example C from appendix to DAS 260)

Private limited liability entity A, a 40% participating interest of private limited liability entity M, achieved a profit of 400,000, including 100,000 intercompany profit on goods deliveries from A to M. At the end of the year, M had not yet realised any of this 100,000 in a transaction with third parties. At the beginning of the year, M did not have any goods supplied by A in inventory. M recognises 40% of (400,000 – 100,000) = 120,000 profit from participating interest A.

M recognises a profit from participating interest of 120,000, while 40% of 400,000 is equal to 160,000. The difference amounts to 40,000 (= 160,000 – 120,000) and is equal to M's share (40%) in the unrealised profit of 100,000. M also measures the participating interest A 40,000 lower than its share (40%) in A's equity.

The recognition of profit in the financial statements of the participating entity depends on the type of intercompany transaction.

15.2.2 Downstream sale

If an entity transfers an asset or liability to a participating interest measured in accordance with the net asset value method, only profit or loss resulting from this transfer must be recognised in proportion to the relative interest that third parties have in that participating interest (proportional determination of profit or loss). Therefore, no profit or loss resulting from this transfer is recognised for in proportion to the relative interest that the entity has in that participating interest (DAS 260.208).

Example: Downstream sale to a participating interest

Parent entity M supplies D, a 40% participating interest, goods for 400 with a profit mark-up of 100. At the reporting date 30% of these goods have been resold to third parties. M measures D at net asset value in both its consolidated and company-only financial statements.

The recognition is identical for the consolidated and company-only financial statements. Of the intercompany gain, 30 (the part resold by D to third parties) is realised in a transaction with third parties. Of the goods not yet resold to third parties, M may only recognise a gain in proportion to third parties' relative interest in D, i.e. 60%. M is therefore allowed to only recognise 60% of the unrealised intercompany gain of 70, or 28 (= 40% of 70) should be eliminated. On balance therefore, M recognises a profit of 72 on this transaction.

The elimination journal entry in M's company-only and consolidated financial statements is as follows:

Net revenue	28	
Accruals and deferred income		28

15.2.3 Upstream sale

If a participating interest measured in accordance with the net asset value method transfers an asset or liability to the participating entity, this entity should recognise its share in the profit or loss from the participating interest on this transfer only in its profit or loss if the asset or liability in question has been sold or resold to a third party or has been realised through own depreciation (DAS 260.209).

Example: Upstream sale by participating interest (not a group entity) to the parent entity

D, a 40% participating interest, supplies goods to parent entity M for 400 with a profit mark-up of 100. 30% of these goods have been resold to third parties by the reporting date. M measures D in its company-only and consolidated financial statements at net asset value. D's profit (including intercompany gain) for the financial year is 500.

The recognition in the consolidated and company-only financial statements is identical. The profit or loss from participating interest D is calculated exclusive of the unrealised intercompany gain of 70 (=70% of 100). Exclusive of any unrealised intercompany gain, D's profit is 430 (= 500 - 70). M's profit from participating interest D is 40% of this, or 172 (= 40% of 430) instead of 200 (= 40% of 500) if there is no unrealised intercompany gain. The difference of 28 (= 200 – 172) is 40% of the unrealised intercompany gain (= 40% of 70).

15.2.4 Sidestream sale

If an asset or liability is transferred between two participating interests, both of which are measured according to the net asset value method, the entity should limit its share in the profit or loss of the selling participating interest to the part corresponding to the decrease in its relative interest in the transferred asset or liability. If the transfer does not result in a decrease in the relative interest of the entity in the transferred asset or liability, the entity does not recognise any profit or loss from participating interest in connection with this transfer (DAS 260.210).

Example: Sidestream sale (1)

If a 100% participating interest (A) sells an asset or liability to an 80% participating interest (B), the parent entity recognises 20% of the intercompany gain in A in its profit or loss from participating interest A. If B were to sell an asset or liability to A, the participating entity would not recognise any profit or loss on this transaction when determining its profit or loss from participating entity B as its relative interest in the transferred asset or liability would not decrease.

Example: Sidestream sale (2)

D1, a 40% participating interest of parent entity M, supplies goods to D2, a 25% participating interest of M for 400 with a profit mark-up of 100. At the reporting date 30% of these goods have been resold by D2 to third parties. M measures participating interests D1 and D2 at net asset value. In the financial year, D made a profit of 500 (including the intercompany profit of 100).

The treatment is identical for the consolidated and company-only financial statements. As regards the unrealised intercompany gain of 70 (= 70% van 100), M only recognises a profit from D1, the selling participating interest, corresponding to the decrease in M's relative interest in the transferred asset. This decrease is 15% (= 40% - 25%).

M's profit from its participating interest D1 is determined as follows:

	D1 profit	M's share	Profit from participating interest D1
Realised profit	430	40%	172.0
Unrealised profit	70	15%	10.5
	500		182.5

If there was no unrealised intercompany profit, M would recognise a profit from participating interest D1 of 200 (= 40% of 500). Of the unrealised profit in D1, M does not recognise 17.5 (= 25% of 70) in its profit from its participating interest, as a result of which M recognises a profit from participating interest D1 of 182.5.

15.2.5 Presentation

The proportional recognition of intercompany profit takes place by eliminating the part of the profit that may not yet be recognised. The elimination in the profit and loss account and the balance sheet occurs as follows:

- Profit and loss account: in the case of a downstream sale, elimination of the intercompany profit or loss can take place by crediting or charging the item in the profit and loss account in which the intercompany transaction is recognised (e.g. net revenue or other income). The option to deduct the intercompany profit or loss to be eliminated from the profit or loss from the relevant participating interest has been removed. In the case of an upstream or sidestream sale, the elimination is included in the item profit or loss from participations (DAS 260.206).
- Balance sheet: on the balance sheet eliminations can be recognised as accrual or by recognising the elimination in the item participating interest. In the case of upstream sales, the elimination can alternatively be recognised in the measurement of the asset obtained. In the case of a 100% participating interest, the intercompany transaction then does not result in a difference between the carrying amount of the asset in the company-only financial statements and the carrying amount of the asset in the consolidated financial statements (DAS 260.207).

15.2.6 Realisation of intercompany profits or losses

If realisation has taken place through the sale of the transferred asset or liability to a third party, the participating entity may recognise the profit in full. In the event of an intercompany transfer of fixed assets, realisation also takes place by depreciation by the participating interest. After all, the intercompany profit or loss included in the acquisition cost is also depreciated. In both cases, there is realisation as the realised intercompany profit or loss is no longer part of the measurement of the transferred asset or liability on the balance sheet of the participating interest (DAS 260.203).

If an intercompany profit or loss is considered to be unrealised and the purchasing (in the case of a downstream or sidestream sale) participating interest is disposed in whole or in part, this disposal transaction must be regarded as a realisation moment. This (partial) disposal results in recognising the profit or loss that has not yet been realised (DAS 260.205).

15.2.7 Elimination of losses

The Dutch Accounting Standards Board has clarified the elimination of losses in the amended DAS 260. A loss on an intercompany transaction is also (proportionally) eliminated. However, such loss may be an indication of an impairment. The extent to which an impairment loss needs to be recognised is explained by the standard on impairment of fixed assets (see Chapter 10) or the standard on inventories (see Chapter 11 on the measurement of inventories at lower net selling price). The amount of any impairment does not (by definition) correspond to the loss on the intercompany transaction (DAS 260.202). See also the second example in paragraph 15.4.

15.2.8 Elimination in case of negative net asset value

In principle, if the net asset value of a participating interest is negative, that interest is measured at nil (see paragraph 9.2.6). The question is the extent to which elimination items that would normally be deducted from the value of that interest should be maintained if that deduction results in that interest having a negative net asset value. The Dutch Accounting Standards Board stipulates in the amended DAS 260 that if the value of a participating interest is negative according to the net asset value method and that interest is therefore measured at nil, intercompany profit or loss should be eliminated as long as the assets in question have not been sold to third parties or otherwise realised (DAS 260.204). The fact is that, in this situation too, any intercompany profit or loss is only realised if assets have been transferred to a third party or depreciated (amortised). In this situation, on the balance sheet the elimination entry is recognised as accrual.

15.2.9 Dividend payment higher than value of participating interest itself

If a participating interest pays dividends from distributable equity, the participating entity should deduct this dividend from its measurement of that interest according to the net asset value method. In case of an upstream or sidestream sale, a dividend payment may also be made on any unrealised intercompany gain since in such cases nothing is eliminated in the selling participating interest. The fact is that the selling participating interest may include the entire (as yet unrealised) intercompany gain in its company-only financial statements. This could result in the dividend payment exceeding the measurement of the participating interest in the participating entity's financial statements, as any unrealised intercompany gain is eliminated from the profit or loss from that participating interest. If the participating entity's company-only financial statements recognise a negative value for the participating interest as a result of the eliminated (i.e. as yet unrealised) intercompany gain, this eliminated intercompany gain is presented in accruals and deferred income.

15.3 Intracompany transactions with and between participating interests measured at acquisition cost or current value

In the case of measurement of participating interests at acquisition cost or current value, a participating interest is considered as an indivisible asset, as opposed to a participating interest measured according to the net asset value method. In fact, it is then considered as an independent entity for measurement purposes. No consideration is given to its underlying assets and liabilities nor, therefore, to assets or liabilities in which an intercompany profit or loss has been recognised. On this basis, there is no (proportional) elimination of the intercompany profit or loss. This does justice to the nature of an indivisible asset and the measurement of the participating interest in question on acquisition cost or current value. For transactions within the ordinary operations of the transferring and acquiring companies at fair (market) prices, direct and full recognition of profit or loss is therefore appropriate (DAS 260.301).

Downstream sales
If the participating entity transfers an asset or liability to a participating interest measured at acquisition cost or current value, the gain or loss on this transfer is recognised directly and fully in profit or loss. However, if the gain on the transfer is not actually realised, no profit should be recognised (DAS 260.302).

DAS 260 does not address the situation in which there is a loss that is not actually realised. However, such a situation will usually lead to an impairment. In that case, an impairment is recognised.

A gain on a transfer to a participating interest is not actually realised if a transaction is solely aimed at recognising a gain and hence higher distributable equity, when in fact there is no real change in the economic situation. In this situation, recognition of profit depends on the outcome of a careful analysis of the circumstances. For example, if the acquiring company owes or finances the purchase price by issuing shares and, in addition, considered independently would not be able to repay the purchase price in cash given its financial position, this may be reason to consider the gain on the transaction as unrealised (DAS 260.301).

Upstream and sidestream sales
If a participating interest measured at acquisition cost or current value transfers an asset or liability to the participating entity (upstream sale) or to another participating interest (sidestream sale), the participating entity does not recognise profit or loss in respect of this transfer (DAS 260.303).

15.4 Intercompany transactions in the consolidated financial statements

Intercompany transactions between group entities and therefore also gains and losses on intercompany transactions are fully eliminated from both the balance sheet valuation and the group profit or loss to the extent that those profits or losses have not yet been realised through a transfer of the acquired asset or liability to third parties outside the group or through depreciation (DAS 260.401). See also paragraph 33.5.3.

It is irrelevant here whether or not the group entities between which a transaction has taken place are consolidated. Indeed, such profits or losses are also eliminated if a group entity is not consolidated (e.g. due to immateriality). The profits or losses on intercompany transactions with other group companies (consolidated or not) are fully eliminated. The elimination in the profit and loss account must also take place in full for – if applicable – the recognised revenue and cost of sales (DAS 260.401).

Full elimination should also take place for non-wholly owned interests in group entities. In upstream or sidestream sales, where the entity has a non-100% interest in the selling group entity, the elimination from the group profit or loss is pro rata allocated to the minority share based on the share of the minority in the selling group entity (DAS 260.401).

Example: unrealised gain on a transfer of fixed assets within the group

Company A has an 80% interest in B's shareholders' equity. B is a group entity of A and buys a machine on 1 January of year 1 for 4 million. The economic and useful life of the machine is 10 years. On 1 January of year 3, B sells the machine to A for 3.6 million (upstream sale). The effect of B's sale to A must be eliminated from A's consolidated financial statements as at 31 December of year 3 (the reporting date).

At 31 December of year 3, the carrying amount of the machine in A's accounts is 3.15 million. The depreciation charge recognised for year 3 is 450,000. The calculation of this depreciation charge assumes that the machine is depreciated on a straight-line basis over eight years assuming a sales price of 3.6 million.

B recognises a gain of 400,000 from the sale of the machine. If the machine had not been transferred, the fixed asset would have been recognised at 2.8 million on the balance sheet at 31 December of year 3 and a depreciation charge of 400,000 would have been recognised for year 3.

The elimination for the consolidated financial statements for year 3 is as follows:

Gain on the sale (= 3,600,000 - 3,200,000)	400,000	
Machine (= 2,800,000 - 3,150,000)		350,000
Depreciation charge for 2009 (= 450,000 - 400,000)		50,000

The carrying amount adjustment of 350,000 consists of the following two eliminations:

Machine acquisition value (= 4,000,000 - 3,600,000)	400,000	
Accumulated depreciation of the machine (= 1,200,000 - 450,000)		750,000

The adjustment made to the non-controlling interest in the consolidated profit and loss account is as follows:

Non-controlling interest in the gain from the sale (= 20% of 400,000)	80,000
Non-controlling interest in the over-depreciation (= 20% of 50,000)	(10,000)
Decrease in non-controlling interest in profit or loss	70,000

Example: unrealised losses on the transfer of fixed assets within a group

Company A has an 80% interest in B's shareholders' equity. B buys a machine on 1 January of year 1 for 4 million. The economic and useful life of the machine is 10 years. On 1 January of year 3, B sells the machine to A for $2.4 million.

In preparing A's consolidated financial statements as at 31 December of year 3 (reporting date), the effect of B's transfer to A must be eliminated. This calculation assumes that the machine is depreciated on a straight-line basis over 8 years assuming a sales price of 2.4 million. The depreciation charge recognised by A for year 3 is therefore 0.3 million (= 2.4 million / 8). On 31 December year 3, the carrying amount of the machine in the accounts of A is therefore 2.1 million (= 2.4 million – 0.3 million).

The carrying amount at B at the time of sale was 3.2 million (= 4 million * 8/10). B therefore recognises a loss of 0,8 mln (= 3,2 mln – 2,4 mln) from the sale of the machine. If the machine had not been transferred, the fixed asset would have been recognised at 2.8 million (= 4 mln * 7/10) on the balance sheet at 31 December year 3. The depreciation charge for year 3 would then have been 0,4 mln (= 4 mln / 10).

Assuming that A can continue to apply the original carrying amount for the fixed asset, in preparing the consolidated financial statements the following entries for year 3 are made:

Acquisition value of the machine (= 4,000,000 - 2,400,000)	1,600,000	
Depreciation charge (= 400,000 - 300,000)	100,000	
Loss on sale (= 3,200,000 - 2,400,000)		800,000
Accumulated depreciation of the machine (= 1,200,000 - 300,000)		900,000

The adjustment made to the non-controlling interest in the consolidated profit and loss account is as follows:

Non-controlling interest in the loss on the sale (= 20% of 800,000)	160,000
Non-controlling interest in the understatement of depreciation (= 20% of 100,000)	(20,000)
Increase in non-controlling interest in profit or loss	140,000

The fact that the transfer within the group was made at a lower amount than the carrying amount is an indication that this machine may be impaired. A should therefore determine the recoverable amount of the machine on the basis of DAS 121.202. Any impairment loss is recognised immediately as an expense in the profit and loss account in line with Article 2:387(5) NCC (DAS 121.402).

Difference between company-only and consolidated elimination of intercompany profit or loss
The qualification as group entity or not is irrelevant and does not affect the recognition of intercompany transactions in the company-only financial statements. Therefore the only relevant factor is the measurement basis that the entity applies to the acquiring participating interest (downstream sale) or the transferring participating interest (upstream sale and sidestream sale).

One possible consequence of the proportional determination of profit or loss in transactions between consolidated non-wholly owned interests is therefore a discrepancy between the company-only profit or loss on such transactions (i.e. the proportional determination of profit or loss) and the profit or loss recognised in the consolidated financial statements (full elimination). This is due to the different natures of the company-only financial statements (proportional determination of profit or loss based on the participating entity's ongoing economic interest), versus the consolidated financial statements (full elimination of such profits or losses as the group is considered as a single economic entity) (DAS 260.402).

Example: Difference between company-only and consolidated equity and profit or loss (based on example F from appendix to DAS 260)

Company A is an 80% participating interest of company M. M measures A in its company-only financial statements at net asset value. At the beginning of the year, there were no goods supplied by M in A’s inventory. At the end of the year, A still had certain goods supplied by M in inventory on which M realised a transaction profit of 100,000 (before elimination). For its consolidated financial statements, M must eliminate 100,000 profit. For its company-only financial statements, M eliminates only 80% of 100,000 = 80,000.

In appendix 2, the differences in eliminations in the consolidated and company-only financial statements are further elaborated in examples for downstream sales, upstream sales and sidestream sales.

15.5 Recognition in the financial statements of the participating interest

In its own financial statements the participating interest shall recognise obtained assets or liabilities from downstream or sidestream sales at the time of acquisition in accordance with the chapter relevant for these assets or liabilities. Thereby therefore is no elimination (DAS 260.501).

There is also no elimination in the own financial statements of the transferring participating interest in an upstream or sidestream sale, and the profit or loss on the intercompany transaction is fully recognised. The elimination from the profit or loss from the transferring participating interest required by the participating entity in the case of upstream and sidestream sales, does not take place in the financial statements of the transferring participating interest itself (DAS 260.502).

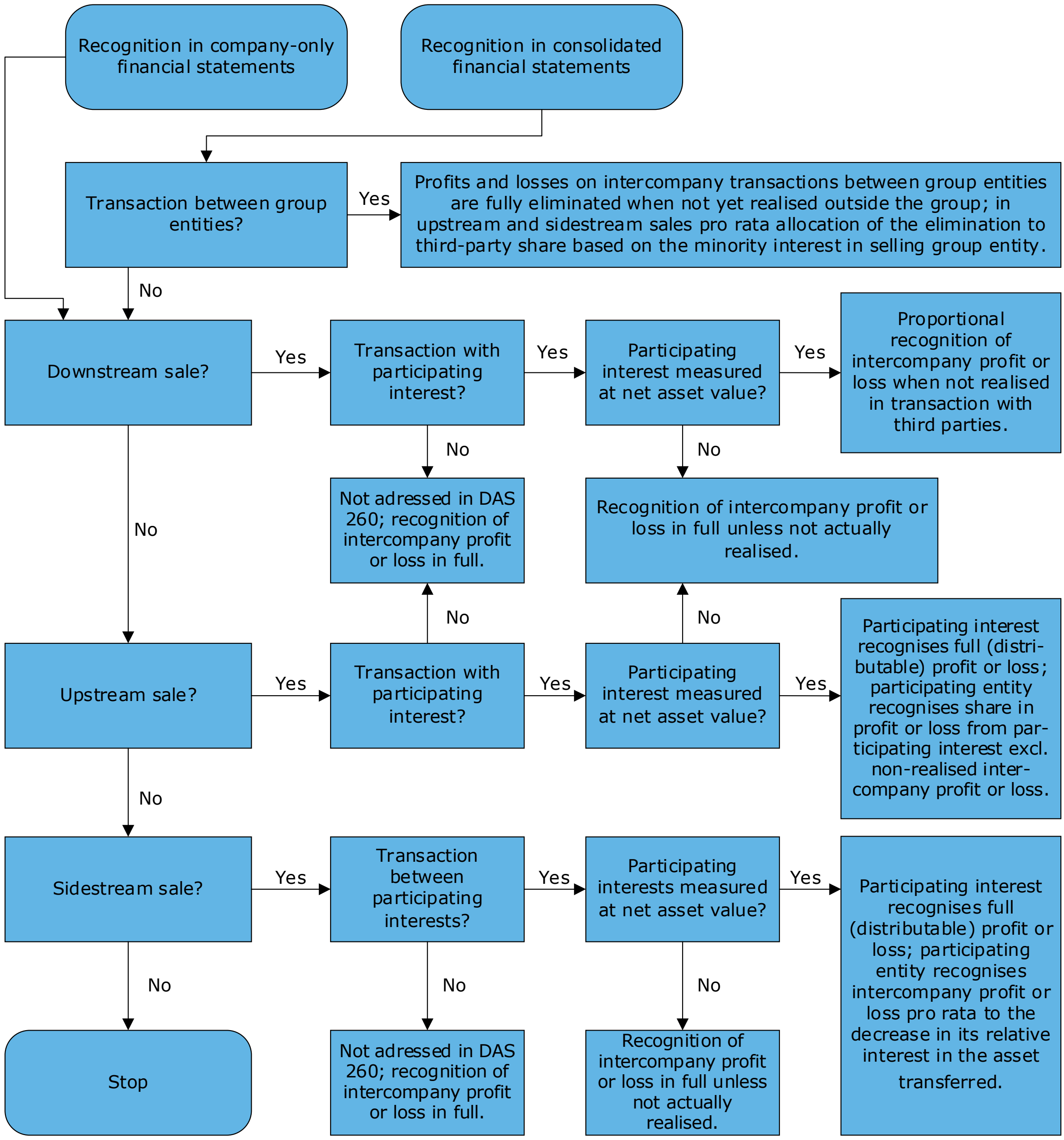
15.6 Exemptions for medium-sized and small entities

There are no exemptions for medium-sized and small entities.

15.7 Significant differences from IFRS

There are no significant differences with IFRS as regards the recognition of intercompany profit or loss.

Annex 1. Recognition of intercompany transactions



Appendix 2. Differences in eliminations in the consolidated and company-only financial statements further elaborated in examples for downstream sales, upstream sales and sidestream sales

Example: Downstream sale of goods to group entity

Parent entity M supplies goods to a 60% subsidiary D for 500 including a profit mark-up of 100. 30% of these goods have been resold to third parties by the reporting date. M measures D at net asset value in its company-only financial statements.

The realised portion of the intercompany transaction is 30 (= 30% of 100). Consequently, 70 is the profit not realised outside the group. Of the unrealised intercompany gain, M's company-only financial statements only recognise gain in proportion to the non-controlling interest in D. The non-controlling interest is 40% and 28 (= 40% of 70) of the unrealised intercompany gain is therefore considered realised. This implies an elimination of 42 (= 100 - 30 - 28) in the intercompany gain of 100, as this amount is not considered realised.

Journal entry in company-only financial statements M:

Net revenue	42	
Accruals and deferred income		42

In the consolidated financial statements the entire intercompany gain of 70 should be eliminated as D is a group entity. In the journal entry for elimination shown below, we assume that revenue of 500 and cost of 400 are recognised at M. These amounts are eliminated in the consolidated financial statements. In the consolidation also inventories of D are included with a profit mark-up of 70 to be eliminated. At the same time, D includes 30 in the cost of sales which is due to M's profit mark-up. This 30 should also be eliminated. Viewed from the perspective of the consolidated profit and loss account, gain is now recognised only on sales made from the group to third parties. Viewed from the perspective of the consolidated balance sheet, the transfer of inventories from M to D does not affect their measurement. The fact is that those inventories remain within the group.

Journal entry for elimination in M's consolidated financial statements:

Net revenue (M)	500	
Cost of sales (M)		400
Inventory (D)		70
Cost of sales (D)		30

The consolidated profit and loss account now recognises, on balance, the realised intercompany gain of 30 (= 100 - 70). Of this, 12 (= 40% of 30) is attributed to the third-party interest in subsidiary D. Therefore, ignoring taxes, 18 (= 60% of 30) is added to the group equity allocable to M's shareholders. The downstream transaction has increased company-only profit or loss and equity by 58 (= 100 - 42). The difference of 40 (= 58 - 18) is due to the fact that 40% of the transaction gain of 100 may be considered as a realised company-only gain while, in the consolidated financial statements, it is either allocated to the minority interest (12) or eliminated (28).

Example: Upstream sale of goods to parent entity

D, a 60%-group entity, supplies goods to its parent entity M for 500 including a profit mark-up of 100.
30% of these goods have been resold to third parties by the reporting date. M measures D in its company-only financial statements at net asset value. D's profit or loss (including intercompany profit or loss) for the financial year is 500.

This profit or loss is eliminated solely in the parent entity's financial statements. However, the selling entity's financial statements recognises this intercompany profit or loss in its entirety.

The intercompany profit realised is 30 (= 30% of 100), while the unrealised portion is 70 (= 70% of 100). M's company-only financial statements determines its profit or loss from participating interest D exclusive of the unrealised intercompany profit or loss in D. Its profit from D is 258 (= 60% of (500 - 70)). The eliminated portion of the intercompany gain is 42 (= 60% of 70).

Since D is a group entity, the entire unrealised intercompany gain of 70 is eliminated in the consolidated financial statements. M's company-only financial statements has already eliminated 42 so that, on balance, another 28 is eliminated in the consolidated financial statements.

In the consolidated financial statements, the eliminated profit or loss is allocated to the minority interest in proportion to the minority share in the selling group entity. Given the complexity of this, this will be explained in more detail based on the consolidated and company-only data of M and D.

The intercompany transaction described above takes place in year 2. In that year, D's profit is 500 and M's profit or loss is solely the profit or loss from participating interest in D.

M and D's company-only balance sheets are as follows:

	31 December year 2		31 December year 1	
	M	D	M	D
Participating interest D	858*	0	600	0
Inventory	350	850	350	700
Other assets	450	930	400	400
Equity	(1,258)	1,500	1,000	1,000
Debt	(400)	(280)	(350)	(100)

* 60% of 1,000 + 258

M's consolidated balance sheet at 31 December year 2 is then as follows:

	M company-only	D company-only	Total	Elimination participating interest	Elimination inter-company	Consolidation M
Participating interest D	858	0	858	(900)	42	0
Inventory	350	850	1,200		(70)	1,130
Other assets	450	930	1,380			1,380
Group equity	(1,258)	1,500	(2,758)	1,500		(1,258)
Non-controlling interest				(600)	28	(572)
Debt	(400)	(280)	(680)			(680)

Group equity is M's share in the group's equity. Non-controlling interest is the share of third parties in the group's equity.

The consolidated profit and loss account for year 2 is as follows (only the relevant parts are included):

	M company-only	D company-only	Total	Elimination participating interest	Elimination inter-company	Consolidation M
Profit or loss after tax	0	500	500		(70)	430
Profit or loss from participating interest	258	0	258	(258)	0	0
Net profit or loss	258	500	758	(258)	(70)	430
Non-controlling interest			0	(200)	28	(172)
Group profit or loss			758	(458)	(42)	258

The eliminations in the consolidated financial statements consist of the elimination of participating interests on the one hand and the elimination of intercompany transactions on the other.

Inventories include an unrealised intercompany gain of 70. In the consolidated financial statements, this is fully eliminated in both the balance sheet measurement and the determination of profit or loss.

The non-controlling interest is determined on the balance sheet as follows: 40% of (1,500 - 70), or 40% of D's equity less the unrealised intercompany profit or loss. The non-controlling interest in the profit and loss account is 40% of (500 - 70), or 40% of D's profit or loss less the unrealised intercompany profit or loss.

The above tables show that M's share in the consolidated profit or loss and equity is equal to M's company-only profit or loss and equity, despite the fact that the eliminations in the consolidated financial statements and in the company-only financial statements are not equal. In the company-only financial statements, only M's share in D (42) is eliminated while in the consolidated financial statements, the entire intercompany profit or loss (70) is eliminated.

Despite this difference in elimination, there are no differences between the consolidated and company-only data because, in the consolidated data, the minority interest is adjusted for its share in the unrealised intercompany gain. Comparing this example (upstream sale) with the previous example (downstream sale), it is noticeable that in the downstream sale example, the company-only and the consolidated profit or loss and equity diverge. The reason for this lies in the fact that M, the head of the group in an upstream sale, also only realises a gain in its company-only financial statements if sold to third parties, just as it does in the consolidated financial statements. In a downstream sale, the intercompany transaction gain is considered as realised in the company-only financial statements to the extent that third parties have an interest in the purchasing group entity, while the consolidated financial statements only recognise the gain on any sale outside the group.

Example: Sidestream sale to a group entity

D1, a 90%-group entity of M, supplies goods to D2, a 70%-group entity (also group entity of M) for 500 including a profit mark-up of 100. 30% of these goods have been resold to third parties by the reporting date. M values both participating interests at net asset value. D1 achieves a profit of 500 (including intercompany profit) in the financial year.

No elimination takes place in the selling subsidiary (D1) or the buying subsidiary (D2). The only elimination is in M.

The intercompany profit realised is 30 (= 30% of 100), while the unrealised portion is 70 (= 70% of 100). When determining its profit or loss from participating interest D1, M only includes this unrealised portion *pro rata* to the decrease in its relative interest in the goods transferred. This relative decrease is 20%, as the goods are sold from a 90% subsidiary to a 70% subsidiary. M recognises 20% or 14 (= 20% of 70) of the unrealised intercompany profit. Its profit or loss from participating interest D1 is determined as follows:

	D1 profit or loss	M's share	Profit or loss from participating interest D1
Realised profit or loss	430	90%	387
Unrealised profit or loss	70	20%	14
Total	500		401

Therefore, M does not recognise a profit of 450 (= 90% of 500) from its participating interest in D1 but rather only 401; this does not include an intercompany gain of 49. This intercompany gain is equal to M's share in the unrealised intercompany gain of D2 (buying subsidiary), or 49 (= 70% of 70).

As D1 is a group entity, the unrealised intercompany gain of 70 is eliminated in full in the consolidated financial statements. In the company-only financial statements, 49 has already been eliminated so that, on balance, 21 remains to be eliminated in the consolidated financial statements.

In the consolidated financial statements, the eliminated profit or loss is allocated to the minority interest in proportion to the minority share in the selling group entity. This will now be explained in more detail based on the consolidated and company-only data of M, D1 and D2.

The company-only balance sheets of M, D1 and D2 are as follows:

	31 December of year 2			31 December of year 1		
	M	D1	D2	M	D1	D2
Participating interests	1,581	0	0	970	0	0
Inventory	0	850	500	0	700	400
Other assets	450	930	0	600	400	0
Equity	(1,981)	(1,500)	(400)	(1,370)	(1,000)	(100)
Debt	(50)	(280)	(100)	(200)	(100)	(300)

The intercompany transaction recognised above takes place in year 2. In that year, D1 and D2 generate a profit of 500 and 300, respectively. M's profit or loss consists solely of the profit or loss from its participating interests (D1 and D2).

M's consolidated balance sheet of M as at 31 December year 2 is as follows:

	M	D1	D2	Total
Participating interests D1 and D2	1,581			1,581
Inventory	0	850	500	1,350
Other assets	450	930	0	1,380
Group equity	(1,981)	(1,500)	(400)	(3,881)
Non-controlling interest				0
Debt	(50)	(280)	(100)	(430)

(consolidated balance sheet, continued)

	Total	Elimination participating interests	Elimination inter-company transaction	Consoli-dation M
Participating interests D1 and D2	1,581	(1,630)	49	0
Inventory	1,350		(70)	1,280
Other assets	1,380			1,380
Group equity	(3,881)	1,900	14	(1,967)
Non-controlling interest	0	(270)	7	(263)
Debt	(430)			(430)

The consolidated profit and loss account for year 2 is as follows (only the relevant parts are included):

	M	D1	D2	Total	Elimination s	Consoli-dation M
Profit or loss after tax	0	500	300	800	(70)	730
Profit or loss from participating interest	611	0	0	611	(611)	0
Net profit or loss	611	500	300	1,411	(681)	730
Non-controlling interest				0	(133)	(133)
Group profit or loss				1,411	(814)	597

The total profit or loss from the participating interest is 611, consisting of 401 from participating interest D1 (as calculated above) and 210 from participating interest D2 (= 70% of 300).

Inventories include an unrealised intercompany profit of 70. In the consolidated financial statements, this is fully eliminated in both the balance sheet measurement and the determination of profit or loss.

On the balance sheet, the non-controlling interest is determined as follows:

Non-controlling interest in D1 (= 10% of 1,500)	150
Non-controlling interest in D2 (= 30% of 400)	120
Non-controlling interest in the intercompany profit or loss (= 10% of 70)	(7)
Total non-controlling interest	263

The non-controlling interest of 133 in the profit and loss account is calculated in exactly the same way (= 10% x 500 + 30% of 300 - 10% x 70).

The tables above show that M's consolidated profit or loss and equity are not equal to M's statutory profit or loss and equity. This is in contrast to the previous example of an upstream sale.

Company-only and consolidated eliminations are not equal. These eliminations can be specified as follows:

	Company-only	Consolidated	Difference
Net revenue	0	(70)	70
Profit or loss from participating interest	(49)	0	(49)
Non-controlling interest	0	7	(7)
Total elimination	(49)	(63)	14

The difference of 14 is equal to M's share in the unrealised intercompany gain recognised in the profit or loss from participating interests (= 20% of 70). The fact that the parent entity's company-only financial statements do recognise a portion of the unrealised intercompany gain in sidestream sales results in a difference between the company-only and the consolidated equity and profit or loss. This is in contrast to upstream sales, where the unrealised portion of the intercompany gain is not recognised in either the company-only or the consolidated financial statements. If M's share in D1 (the selling subsidiary) had been smaller than in D2 (the buying subsidiary), none of the unrealised intercompany gain in D1 would have been recognised in the profit or loss from participating interests in M's financial statements. In that situation, the unrealised intercompany gain would have been fully eliminated in both the company-only and the consolidated financial statements and the equity and profit or loss in both statements would have been equal.

16 Provisions

16.1 Introduction

General
Provisions are recognised to cover liabilities that, by their nature, are clearly defined and considered probable or certain at the reporting date, but where the extent or time of occurrence is unknown. Provisions may also be recognised to cover expenditures to be incurred in a subsequent financial year, to the extent that the occurrence of these expenditures also originate before the end of the financial year and the provision serves to spread expenses evenly over a number of financial years (Article 2:374(1) NCC).

Article 2:384(2) NCC is also relevant in the context of provisions, as it states that only liabilities present at the reporting date must be taken into account. Future obligations and potential losses originating before the end of the financial year may also be taken into account according to this article, if they have become known before the financial statements are prepared.

A cost equalisation provision (as referred to in the second sentence of Article 2:374(1) NCC) does not meet the conditions of DAS 252.201, because on the reporting date there is no liability within the meaning of DAS 252 relating to provisions. Since such a cost equalisation provision is mentioned in the law, it can be formed under NL GAAP. The Dutch Accounting Standards Board mentions one specific cost equalisation provision, the provision for major maintenance. The provision for major maintenance is discussed in Chapter 7.

The following provisions are not addressed in this chapter:

- provisions for tax liabilities (see Chapter 17);
- provisions for pension liabilities (see Chapter 18);
- provisions for losses on construction contracts (see Chapter 12);
- provisions for major maintenance (see Chapter 7);
- provisions for restoration costs (see Chapter 7);
- provisions arising at insurance companies under insurance contracts with policyholders;
- provisions arising from executory contracts, except where they are onerous contracts. An executory contract is a contract for which performance by the relevant parties occurs after the reporting date or for which performance and consideration by both parties have occurred partially and equally up to the reporting date (DAS 252.101).

This chapter also applies to provisions arising from warranty obligations, including financial guarantee contracts that do not meet the definition of a derivative (see paragraph 21.3). These are contracts in which the guarantor will make specific payments if and to the extent that the debtor of the holder of the guarantee fails to meet specific payment obligations. However, contracts concerning financial guarantees that meet the definition of a derivative (such as those based on a non-entity specific 'underlying') fall within the scope of DAS 290 'Financial instruments' and are dealt with in Chapter 21 (DAS 252.102). See paragraph 3 therein.

Importance of defining the scope
The recognition of liabilities in the financial statements depends on the nature of a liability. Failure to correctly determine the nature of a liability may lead to an incorrect method of recognition in the financial statements. When applying accounting standards for liabilities, the following two questions are therefore essential:

- what is the nature of the liability; and
- what accounting standards apply to that liability?

The Dutch Accounting Standards distinguish various types of liabilities. There is no single method of recognition for all types of liabilities. Different rules on when to recognise and how to measure liabilities exist for the different types of liabilities.

Example: Scope

Applying the general provisions of DAS 252 to employee benefits is not in line with the Dutch Accounting Standards. If the provisions on onerous contracts, as contained in DAS 252, were to be applied to employee benefits - which is not acceptable under the Dutch Accounting Standards - each employment contract would have to be assessed separately to determine whether it is an onerous contract! DAS 271 'Employee benefits' applies to the recognition of employee benefits. DAS 271 does not allow recognition of a provision for an onerous employment contract. Only in the event of termination benefits must a liability potentially be recognised. See paragraph 18.3.

16.2 Conditions for forming provisions

A provision relating to liabilities as referred to in Article 2:374(1) NCC must only be recognised if the following conditions are met at the reporting date (DAS 252.201):

- an entity has a legal or constructive obligation;
- it is probable that an outflow of resources will be required to settle that obligation; and
- the amount of the obligation can be reliably estimated.

Provisions must not be made for future losses from operating activities (DAS 252.402), as these are not liabilities within the meaning of DAS 252.201.

Legal or constructive obligations
The first condition for forming a provision is that an obligation must exist. Two types of obligations can be distinguished:

- a legal obligation; and
- a constructive obligation.

A legal obligation is one that arises from a contract or the law (DAS 252.0). A constructive obligation is an obligation that derives from the entity's actions, where (DAS 252.0):

- the entity has indicated to other stakeholders by past practice, published policies or a sufficiently specific current statement that it accepts certain obligations; and
- as a result, the entity has created a legitimate expectation in these stakeholders that it will fulfil these obligations.

A provision must therefore be recognised for obligations if a past event gives the entity no real alternative but to settle the liability (DAS 252.203). Only in exceptional cases will it be unclear whether an obligation exists. A past event must then be used to conclude whether an obligation exists. This is the case if the existence of an obligation is probable based on all information available (DAS 252.202).

Furthermore, the following is also relevant for recognising provisions (DAS 252.204):

- an obligation always involves a party to whom the obligation is owed. However, it is not necessary for the entity to know the identity of the party to whom the obligation is owed. The obligation may even exist towards society as such. Having said that, the decision that results in the obligation must be explained to those affected in such detail that they have a legitimate expectation that the entity will fulfil its responsibilities;
- an event that does not immediately result in an obligation may do so at a later date as a result of a change in the law or an act of the entity (e.g. a sufficiently detailed public statement) that results in a constructive obligation;
- where details of a proposed new law have yet to be finalised, an obligation only arises if the legislation is virtually certain to come into force in the wording as known at the time.

Probable outflow of resources
The second condition to be met before a provision is recognised is that settlement of the obligation will probably require an outflow of resources. An outflow of resources is probable if the probability of occurrence is greater than the probability of non-occurrence (i.e. a probability of occurrence greater than 50%).

Reliable estimate
The third condition is the ability to make a reliable estimate of the amount of the obligation. Only in very exceptional cases will it not be possible to make a reliable estimate of the amount of the obligation (DAS 252.201). The use of estimates is an essential aspect of preparing financial statements and does not undermine their reliability. Especially in the case of provisions, which by their nature are more uncertain than most other balance sheet items, estimates will have to be made. If an obligation arising from a past event is not provided for in whole or in part because its

amount cannot be determined with sufficient reliability, this fact must be disclosed in the notes (DAS 252.508). See Chapter 20 for further details.

Example: Recognition of provisions

According to a new provision in Dutch law that took effect on 1 July of year 1, company A is obliged to install smoke filters in chimney pipes before 1 July of the following year (year 2). A has not installed the smoke filters at the end of year 2. In the event of an audit by the environmental inspectorate (after 1 July of year 2), A will be fined based on its revenue. At the time the financial statements for year 2 are prepared, A has not yet been audited by the environmental inspectorate.

Should A recognise a provision at the end of year 1 for the costs of installing the smoke filters? And at the end of year 2?

At the end of year 1, A has no obligation to install smoke filters. A therefore has no basis for recognising a provision for the costs of installing the smoke filters.

At the end of year 2, A still has not incurred a liability in respect of the costs of installing the smoke filters. A liability only arises when the smoke filters are actually installed. At that point, A must assess whether the costs must be capitalised (see paragraph 7.2). A also recognises no provision for the costs of installing the smoke filters as at 31 December of year 2.

Should A recognise a provision at the end of year 1 for any fine to be expected? And at the end of year 2?

At the end of year 1, A has not breached the law because the legislation does not come into force until 1 July of year 2 and, therefore, A can avoid the fine by its own future actions (installing a filter). At the end of year 1, A therefore has no basis for recognising a provision for any fine to be expected (DAS 252.204).

A has breached the law at the end of year 2, which creates a legal obligation to pay a fine. A must therefore, at the end of year 2, recognise a provision for an expected fine if this is probable and the criteria for recognition of a provision are met. This will depend on the details of the relevant legislation and the enforcement policy of the government.

Future obligations
Future obligations and potential losses originating before the end of the financial year may also be taken into account if they have become known before the financial statements are prepared (Article 2:384(2) NCC). The use of the word 'may' is striking. Apparently, the entity can choose whether or not to take into account foreseeable obligations and potential losses originating before the end of the financial year. This phrase might suggest that an entity has a lot of leeway in deciding whether or not to recognise provisions. However, that is very much not the case. This provision, which is based on Article 9 of EU Directive 2003/51/EC, was included in the law partly to avoid a conflict with the provisions of IAS 19 as in force at the time of publication of the Directive (2003). At the time, IAS 19 provided for a mechanism to spread certain gains and losses - especially actuarial profits and losses - over more than one financial year (known as the 'corridor' approach). As a result, under that version of IAS 19, it was possible that part of the pension obligation at the reporting date was not recognised on the balance sheet. Incidentally, this corridor approach was abolished by an IAS 19 amendment in 2011.

Furthermore, the provision that future obligations may be taken into account is in line with what the Dutch Accounting Standards Board states regarding the formation of restructuring provisions. In fact, if a formalised detailed plan is present as at the reporting date, but only after the reporting date but before the preparation of the financial statements the entity creates the legitimate expectation to those affected that the restructuring will be carried out, the entity can choose whether or not to include a provision on the balance sheet (DAS 252.416). In this situation, no obligation actually existed as at the reporting date and no provision could otherwise be recognised. See also paragraph 16.7.1.

Situations that are not a reason to recognise a provision
No provision may be recognised in the following situations:

- impairments of assets. According to Article 2:374(2) NCC, an impairment of an asset may not be reflected by recognising a provision. Impairments of assets must be recognised on the balance sheet by deducting them from the relevant assets (DAS 252.104). Examples include impairments of fixed assets, the provision for obsolete inventories and the provision for bad debts, which are deducted from the corresponding asset item. These examples actually involve an impairment of the corresponding assets, although the term 'provision' is used for this purpose; and
- future losses from operating activities. Provisions are not recognised for future losses from operating activities as they do not meet the conditions for recognising a provision (DAS 252.402). After all, there is no obligation within the meaning of DAS 252. However, the expectation of future losses from operating activities is an indication for impairment of assets used for the relevant operating activities. An entity must then test whether these assets need to be impaired (DAS 252.403). For this, see paragraph 10.

Example: Future losses from operating activities

A company expects underutilisation losses resulting from unutilised production capacity in the new financial year. Due to the long preparation time needed for any new orders, a short-term order inflow cannot solve this problem.

No provisions may be recognised for these expected future losses from operating activities. Expected underutilisation losses do indicate impairment of assets used for production.

Future actions
If the entity can avoid future expenditures by a future action, the entity has no obligation to incur those expenditures in the future and no provision may be recognised. Only those obligations that arise from past events and that continue to exist independently of the entity's future actions lead to the recognition of a provision (DAS 252.204). As a result, a management board decision to restructure can never result in a provision until this decision has been communicated to the outside world, because the restructuring could still be prevented by a future action (a future management board decision). Paragraph 16.7.1 discusses the conditions for recognising a restructuring provision in more detail.

See Annex 1 to this chapter for a schematic overview of the recognition of provisions and contingent liabilities.

16.3 Estimating the amount

Best estimate
If all the conditions for recognising a provision are met, the next step is to determine the amount to be recognised as a provision. This amount must be the best estimate of the amounts necessary to settle the relevant obligation at the reporting date. In arriving at this best estimate, account must be taken of the risks and uncertainties inevitably associated with many events and circumstances (DAS 252.301). The best estimate is the amount that an entity acting rationally would pay to settle the relevant obligations or to transfer them to a third party (DAS 252.302). It is noted that the judgement of an entity's management determines the estimate of the amount of the provision. Management will base its judgement on experience in similar transactions and, in some cases, on reports from independent experts. Subsequent events are also taken into account in making the estimate if they provide further information about the amount of the liability at the reporting date (DAS 252.303). In determining the amount to be recognised as a provision, a distinction must be made between two different situations: a large number of similar cases and an individual case.

Large number of similar cases
When determining a provision to cover a large number of similar obligations, the amount of the provision is estimated using the weighted average of the possible outcomes. Here, the weighting is based on the probability of the possible outcomes occurring, which leads to the 'expected value' (DAS 252.304).

Example: Determining the provision for a large number of similar cases

A company faces 100 legal claims, each with a 40% chance of success that no payment will have to be made and a 60% chance of a negative outcome for the company. The amount of each individual claim is 1,000.

It is statistically plausible that 60% of the claims will result in a payment of 1,000. The best estimate of the provision is 60,000 (= 60% of 100 x 1,000). This is the expected value.

Individual case

When determining a provision for an individual case, the outcome with the highest probability is usually the best estimate of the size of the liability. However, even in such a situation, other possible outcomes are taken into account. If these outcomes predominantly lead to a higher or lower amount than based on the outcome with the highest probability, the provision is set at a higher or lower amount, respectively, than the outcome with the highest probability (DAS 252.305).

Example: Determining the provision for an individual case (1)

A company has a legal claim, with a 40% chance of success that no payment will have to be made and a 60% chance of a negative outcome for the company, with the total claim amounting to 1,000,000 having to be paid.

The expected value cannot be used on this issue, as the outcome will never be 600,000 (= 60% of 1,000,000). The outcome will either be 0 or 1,000,000. A provision must be recognised based on the individual most likely outcome. In this example, it is likely that the claim will result in total costs of 1,000,000 and therefore a provision must be recognised for the full amount of the claim.

Example: Determining the provision for an individual case (2)

A company has sold a machine for an amount of 30 million. The company has agreed a warranty scheme with the customer for a period of ten years. It is stipulated that an important part of the machine must be replaced at the company's expense in case of a defect. Each replacement costs 1 million. Experience shows that there is a 30% chance of one defect, a 50% chance of two defects and a 20% chance of three defects.

The individual most likely expectation is that of two defects. Two defects cost the company 2,000,000. The expected value is 1,900,000 (= 30% of 1,000,000 + 50% of 2,000,000 + 20% of 3,000,000). The expected value cannot be used on this issue, as the outcome will never be 1,900,000. In this case, a provision must be recognised in the amount of the individual most likely amount of 2,000,000.

Example: Determining the provision for an individual case (3)

A company has sold a machine for an amount of 30 million. The company has agreed a warranty scheme with the customer for a period of ten years. It is stipulated that an important part of the machine must be replaced at the company's expense in case of a defect. Each replacement costs 1 million. Experience shows that there is a 40% chance of one defect, a 30% chance of two defects and a 30% chance of three defects.

The individual most likely expectation is one defect. One defect costs 1,000,000. The expected value is 1,900,000 (= 40% of 1,000,000 + 30% of 2,000,000 + 30% of 3,000,000). In this case, the chance of the most likely outcome in the amount of 1,000,000 is 40%. However, the chance of the costs being higher is 60%. The outcome closest to the expected costs is 2,000,000. Furthermore, it is probable (a more than 50% chance) that there will be an outflow of resources amounting to 2,000,000. In this case, the best estimate of the provision amounts to 2,000,000.

In practice, it is possible that only a range of possible outcomes can be given in the determination of a provision for an individual case, without any indication of which outcome is the most probable. In that case, the provision must be set at the average of the range of possible outcomes and it is not permitted to record the highest or the lowest amount in the series as a provision.

Future events
In determining the amount recognised as a provision, future events that may be significant to the amount required to settle an obligation must be taken into account if there is sufficient objective evidence that those events will occur (DAS 252.308). An example of this is a situation where, in determining the amount of the provision for cleaning up existing environmental pollution, a company takes into account an expected decrease in the associated costs because of future technological developments. Of course, there must be sufficient objective evidence of these future technological developments.

Expected transfer of assets
However, income from the expected transfer of assets may not be taken into account when determining the amount of the provision (DAS 252.309). This holds true even if the expected transfer of assets is closely related to the event leading to the recognition of the provision (DAS 252.310). An example is a situation where a company recognises a restructuring provision for the costs associated with the discontinuance of an operating activity. In that case, the expected sales revenue of the assets used for this operating activity may not be taken into account. This sales revenue may only be recognised if the conditions for revenue recognition are met.

Reimbursement by a third party
In some cases, an entity can recover all or part of the expenditures of settling a provision from a third party, for example on the basis of an insurance contract, an indemnity or guarantees. In such a situation, the entity can only recognise this reimbursement to be received from a third party when it is probable that this reimbursement will actually be received (DAS 252.311).

If it is probable that reimbursement will be received from a third party on settlement of the obligation, the entity will still remain liable for the entire amount if this third party fails to make payment for any reason. Therefore, a provision must be recognised for the entire amount of the obligation and a separate asset is recognised equal to the reimbursement expected (DAS 252.312), on condition that the recognition criteria are met. The amount recognised as reimbursement may not exceed the amount of the provision. However, it is permitted to present the expense from the recognition of the provision and the income from the reimbursement to be received in the profit and loss account on a net basis (DAS 252.313).

Example: Reimbursement by a third party

An animal feed company is being held liable for loss and damage caused by poor animal feed. The company's lawyer expects the company to have to pay this loss and damage but, in turn, has now held a liquid fat supplier liable on behalf of the company. The lawyer believes he has a very strong case and expects to recover at least the claim paid and legal aid costs. However, the fat supplier's financial position is worrisome. At the time of preparing the financial statements, the fat supplier has applied for a payment moratorium.

A provision must be recognised for the claim filed against the animal feed company, as it is probable that the animal feed company will be ruled against in the proceedings. Recourse against the fat supplier must not be taken into account when setting the amount of the provision, as the animal feed company remains liable for the loss and damage caused by the poor animal feed if the fat supplier were unable to pay.

Given the fat supplier's poor financial position, it is not probable that the recourse will lead to future receipts. Capitalisation of the recovery options is therefore not permitted.

16.4 Measurement of provisions at present value

If the effect of the time value of money is material, provisions must be measured at the present value of the expenditures necessary to settle the related obligations or losses (DAS 252.306). For financial years beginning on or after 1 January 2020, provisions may only be measured at face value if the effect of the time value is not material. Whether the effect of the time value is material depends on such factors as the amount of the provision, the term and the discount rate. In any case, if the period over which the expenditures are discounted is no more than one year, the provision need not be measured at present value and may be recognised at face value instead (DAS 252.306).

Discount rate
The discount rate for discounting expected expenditures must reflect the current market interest rate and the pre-tax discount rate must be used.

The most appropriate current market interest rate is the market interest rate as at the reporting date of high-quality corporate bonds. In the absence of a liquid corporate bond market, the government bond yield will apply as the most appropriate rate (DAS 252.306). The current market interest rate of high-quality corporate bonds (or government bonds, if applicable) ensures that the entity's risk profile does not affect the discount rate, and hence does not affect the amount of the provision.

In determining the discount rate:

a. risks already taken into account when estimating future expenditures must not be included again in the discount rate (DAS 252.306); and
b. estimates of future cash flows and the discount rate must consistently reflect assumptions about price increases resulting from inflation. Estimates of future cash flows and the discount rate are therefore both expressed in nominal terms or both in real terms (DAS 252.307).

Re a. Discount rate and risks
Incorporating risks in the discount rate in the context of the measurement of a provision is a difficult issue to fathom because more risk of variability of future expenditure should generally lead to a *higher* provision, which should therefore *lower* the discount rate (all other things being equal). As a result, lowering a company-specific discount rate to the level of a risk-free interest rate means that risks are priced into the discount rate when measuring a provision. The following example illustrates this.

Example: Discount rate and risks

A company must measure two recently originated environmental obligations that lead to cash outflows over a period of ten years. The company's accounting principle is that the market interest rate of high-quality corporate bonds (in this example with a ten-year maturity) is the discount rate. Obligation A concerns the remediation of outdoor areas for which the exact extent and nature of contamination are known. Obligation B has to do with the remediation of the soil below the structures for which the extent and nature of contamination are not known at present. The company expects the best estimate of the outflow over a period of ten years to be 100 for both obligations. The range of possible outcomes resulting from scenario analyses of obligation B ranges from 40 to 150.

The company wishes to insure both risks and asks an insurer at what premium it can transfer these risks. Insurers typically apply a risk premium that compensates for the uncertainty of the amount and timing (less relevant here) of cash flows. According to the quotation, for obligation A the insurer charges a premium of 5 and for obligation B a premium of 35.

Company A now takes into account the uncertainty either by adjusting the cash flows of obligations A and B and leaving the discount rate unchanged or by lowering the discount rate. In the latter case, the discount rate at which obligation B is discounted will be significantly lower than that of obligation A.

Re b. Inflation
Estimates of future cash flows and the discount rate are both expressed in nominal terms (i.e. including inflation) or both in real terms (i.e. excluding inflation). The effect of inflation on the present value of cash flows then is the same. This is the case if:

- cash flows at future (higher) prices are discounted at a nominal (higher) discount rate (i.e. a discount rate that also covers the inflation expected); or
- cash flows at current (lower) prices are discounted at a real (lower) discount rate (i.e. a discount rate that excludes the effects of general inflation).

Example: Impact of inflation

A BV has estimated that it will have to pay 1,000 per year (current price level) over the next three years to settle an existing obligation. Furthermore, A BV has estimated inflation at 1.5% per year and the nominal discount rate (including inflation) at 4% per year. The present value of the liability can be calculated as follows:

	Year 1	Year 2	Year 3	Total
Cash flows at current prices (i.e. excluding inflation)	1,000	1,000	1,000	3,000
Cash flows at expected future prices (i.e. including inflation) (= cash flow at current prices x 1.5% ^ year x)	1,015	1,030	1,046	3,091
Present value of cash flows (= cash flows at expected future prices / (1 + nominal interest rate of 4%) ^ year x)	976	952	930	2,858

In this example, the real discount rate is 2.46% (= (1 + 4%) / (1 + 1.5%)). This is the rate to be applied to the cash flows at current prices to arrive at the same present value. In real terms, the present value of the liability is then calculated as follows:

	Year 1	Year 2	Year 3	Total
Present value of cash flows (= cash flows at current prices / (1 + real interest rate of 2.46%) ^ year x)	976	952	930	2,858

Discounting cash flows at current prices (1,000 per year) at the nominal discount rate of 4% is incorrect. This would give a present value of 2,776, which is too low.

Change in discount rate
A change in the discount rate represents a change in accounting estimates that must be recognised prospectively in the financial statements (see Chapter 3).

16.5 Changes in provisions

At each reporting date, provisions must be reassessed and adjusted to reflect the best current estimate of their amount. If it is no longer probable that an outflow of resources will be necessary to settle an obligation, a provision must be released (DAS 252.314). Additions to provisions must be charged to the profit and loss account, unless directly charging them to equity is permitted under DAS 240 'Equity' (DAS 252.315). Similarly, amounts released from provisions must be credited to the profit and loss account, unless they may be credited directly to equity.

Additions to provisions and releases from provisions may have to be presented as exceptional items (DAS 252.316). For this, see paragraph 23.7. Based on the nature, amount or occasional character, an addition to a provision or a release of all or part of a provision may be considered an exceptional item. This change in the provision must then be disclosed separately (DAS 270.404).

A provision must only be used for those expenditures for which a provision was originally recognised (DAS 252.318). This means that it is not permitted to charge expenditures to the profit and loss account if a provision has been recognised for them, or to charge expenditures to the provision if the provision was recognised for another purpose (DAS 252.319). If this were different, the consequences of two different events would not be presented separately and no accurate picture of reality would be given.

16.6 Presentation and disclosure

Presentation
Provisions that do not relate to particular assets must be presented separately on the balance sheet as liabilities (DAS 252.501). As it is explicitly stipulated that provisions are not a component of equity, it is not acceptable to use the designation 'reserve' for provisions.

The law provides that provisions are classified according to the nature of the obligations and losses they are intended to cover (Article 2:374(3) NCC). When distinguishing categories of provisions, only the provisions of a sufficiently similar nature must be recognised as one category (DAS 252.504). Provisions for tax liabilities and provisions for pension liabilities must in any event be recognised separately (Article 2:372(4) NCC). When classifying provisions by their nature, merely describing the different categories is not sufficient; the individual amounts of the various categories must be disclosed.

Provisions that differ in nature but whose amount is not material need not be disaggregated. An item need not be disclosed separately in the financial statements if it is immaterial in the financial statements as a whole (Article 2:363(3) NCC). Such provisions may be presented as a single item ('other provisions'). See paragraph 2.10 for determining whether the amount of a provision is material or not.

In the profit and loss account, the expense or release of provisions is presented based on the nature of the obligation for which the provision was formed. However, if provisions are measured at present value, the movement in the provision resulting from the addition of interest is presented as an interest expense (DAS 252.317). This addition of interest reflects the effect of the passage of time. The Dutch Accounting Standards Board believes that recognition as an interest expense allows better comparison of financial statements and that this presentation does more justice to the true nature of these expenses. In our opinion, presentation as interest expense (or income) does not apply to the effect of changes in the discount rate. This concerns a change in the 'value' of the relevant obligation that is not a result of the passage of time. The expense or income arising from this change is presented in the profit and loss account in the same line item as an addition to (or a release of) the relevant provision is presented.

Notes
The notes must set out the nature of a provision in such a way that they clearly identify the relevant liability (DAS 252.501). The law also indicates that provisions must be precisely defined in accordance with their nature (Article 2:374(3) NCC).

As far as possible, the notes indicate the extent to which the provisions must be considered non-current (Article 2:374(3) NCC). In case of uncertainty as to when costs are expected to be incurred or payments are expected to be made, a reasonable choice must be made as to whether the provision is non-current or not (DAS 252.506). A provision or part of a provision that is expected to be settled within one year must be considered current. All other provisions must be considered non-current (DAS 252.507). Incidentally, this does not result in the presentation of the provision as current or non-current, but only in a note to the provision about its current or non-current nature. Settlement also includes converting the provision into a debt payable in the near future.

It is recommended that of the total amount of provisions recognised on the balance sheet at the end of the period, the following be disclosed separately (DAS 252.507):

- the portion expected to be settled within one year; and
- the portion expected to be settled after more than five years.

For each category of provisions, an entity must include a movement schedule for the reporting period disclosing the following (DAS 252.502):

- the carrying amount at the beginning and end of the period;
- provisions newly formed during the period, including increases in existing provisions;
- expenditures recorded during the period and charged to the provision;
- changes due to currency translation differences;
- unused amounts released during the period; and
- the movement during the period resulting from interest accrual and changes in the discount rate (if the provision is measured at present value).

The Dutch Accounting Standards Board recommends including comparative figures from the previous financial year in the movement schedule if this is important for understanding the item in question (DAS 110.127). Furthermore, the following must be disclosed for each category of provisions (DAS 252.503):

- a brief description of the nature of the provision;
- where necessary to provide adequate information, the principal assumptions concerning future events; and

- the amount of expected reimbursement, with disclosure of the assets recognised for that expected reimbursement.

In highly exceptional cases, presentation of a movement schedule or disclosure of one or more of the details required by DAS 252.503 may seriously prejudice an entity's position in a dispute. Although the entity need not provide that information if that is the case, it is in fact required to disclose the general nature of the dispute (DAS 252.505).

16.7 Specific provisions

16.7.1 Restructuring provisions

DAS 252.412 lists a number of examples of situations where a restructuring may occur. These include sale or discontinuance of an operating activity, closure or relocation of business locations in a country or region, changes in the management structure and fundamental restructurings with a material impact on the nature and direction of the operating activities.

An entity must recognise a restructuring provision if the following conditions are met at the reporting date (DAS 252.413):

- the entity has formalised a detailed plan for the restructuring; and
- the entity has created a legitimate expectation to those affected by the restructuring that it will carry out the restructuring, either by starting it or by announcing its main features to those affected by it.

The detailed restructuring plan must include at least the following components (DAS 252.413):

- the activities, or parts of activities, involved;
- the principal locations;
- the location, function and expected number of employees who will receive compensation for the termination of their employment;
- the expenditures involved; and
- when the plan will be implemented.

It is therefore not sufficient for the recognition of a restructuring provision that a management board decision to restructure has been taken before the reporting date. A restructuring provision is only recognised if the entity has started to implement the restructuring plan before the reporting date or if the main features of the restructuring plan have been explained in such detail to those who will be affected by it that a legitimate expectation has been created that the entity will carry out the restructuring (DAS 252.414). A provision related to the sale of an operating activity is not recognised until there is a sales contract (DAS 252.415).

Example: Restructuring (1)

A company announced a restructuring in December. The restructuring plan led to big headlines in all national daily newspapers. The restructuring plan includes the FTE redundancies for the relevant departments. A redundancy plan has also been drawn up, which contains a proposal for the termination benefit. The Works Council has issued a positive recommendation on this restructuring. However, on the reporting date (31 December) no agreement has been reached with the trade unions on some components of the redundancy plan. Furthermore, on the reporting date, individual employees have not yet been notified of their dismissal.

The following considerations are important in determining whether a restructuring provision must be recognised at the reporting date. On the reporting date, the company has formalised a detailed restructuring plan. The Works Council issuing a recommendation is part of the formalisation procedure. See Article 25 of the Works Councils Act. By announcing the main features of the restructuring, this company has also created a legitimate expectation to those who will be affected by the restructuring that the restructuring will be carried out. It did so, among other things, by informing the Works Council as the employees' representative body, but also by publicly announcing these restructuring plans through the press. The fact that the individual employees have not yet been informed of their dismissal on the reporting date is irrelevant here. All the conditions of DAS 252.413 have therefore been met, which means that a restructuring provision must be recognised as at the reporting date. If the trade unions are expected to aim for an improvement of the redundancy scheme in the redundancy plan in particular, the measurement of the restructuring provision must take this into account based on the best estimate of the expected negotiation result.

If, as at the reporting date, the entity meets the condition that a detailed plan for the restructuring has been formalised, but only after the reporting date, but before the preparation of the financial statements, meets the condition of creating a legitimate expectation that the restructuring will be carried out, either by starting it or by announcing its main features to those affected by it, a restructuring provision may be included on the balance sheet (DAS 252.416). However, this is not mandatory. In this situation, it is also permitted not to recognise a provision but to provide information about this subsequent event in accordance with the applicable regulations. However, a method of recognition once chosen must be applied consistently.

See Annex 2 to this chapter for a schematic overview for determining whether a restructuring provision is required.

Example: Restructuring (2)

A company intends to carry out a restructuring. A restructuring plan with the corresponding budget is in place. The negotiations with the Works Council have not been finalised on the reporting date (31 December). A final agreement on the restructuring is reached with the Works Council and communicated to the outside world before the date of preparing the financial statements but after the reporting date.

The following considerations are important in determining whether a restructuring provision must be recognised at the reporting date. The company has formalised a restructuring plan on the reporting date and, by announcing its main features, has created a legitimate expectation - after the reporting date but before the preparation of the financial statements - to those affected by the restructuring that the restructuring will be carried out. This meets the conditions of DAS 252.416, which means that a restructuring provision may be recognised at the reporting date. However, it is also possible not to recognise a restructuring provision but to treat the restructuring as a non-adjusting subsequent event with related disclosures (see paragraph 2.7).

A restructuring provision must only include those costs directly related to the restructuring, i.e. those that are necessary as a result of the restructuring and that are not associated with the ongoing activities of the entity (DAS 252.417). Examples of costs that may not be included in a restructuring provision are:

- marketing costs;
- investment in new systems and distribution networks;
- other expenditures related to future activities of the entity; and
- operating losses during the wind-down period.

Relocation costs resulting from the restructuring and training costs associated with new activities of an entity may not be included in the restructuring provision, either (DAS 252.417).

Example: Restructuring (3)

A restructuring involves merging a number of departments. As a result, costs have to be incurred to align the systems of these departments. A restructuring provision cannot include costs associated with the ongoing activities of the company. The costs of aligning the systems therefore cannot be included in the restructuring provision.

See Chapter 31 for the conditions that apply to recognising a restructuring provision in the event of an acquisition.

If, as a result of a restructuring, a contract becomes an onerous contract, a provision must be recognised. This could be a provision related to (DAS 252.418):

- the remuneration of staff members with whom the employment relationship has been terminated, during the remaining term of the employment contract, to the extent that they can no longer perform normal work;
- periodic benefits, whether or not in addition to benefits from social insurance institutions, in respect of the temporary suspension of staff (including short-time working).

Example: Restructuring (4)

A company is in a restructuring process. The company has not yet made any announcements to the press, but has verbally agreed (and has therefore assumed an obligation) with the lessor before the reporting date to terminate the lease of an office building and pay an early termination fee of 1,000,000. The question is whether a provision must be recognised.

A provision must be recognised for the costs arising from the termination of the lease, as a valid expectation has arisen on the part of the lessor before the reporting date regarding the termination of the lease. A loss is probable, as the company cannot terminate the lease without incurring a penalty. On this basis, a provision must be recognised.

It is noted that, for individual costs, the company must consider whether they meet the requirements for the recognition of a restructuring provision. Moreover, if the company had vacated the leased building before the negotiations with the lessor commenced, regardless of whether the restructuring went ahead the company should have assessed whether an onerous contract existed.

16.7.2 Provisions for onerous contracts

An onerous contract is a contract in which the unavoidable costs of meeting the contractual obligations exceed the benefits expected from the contract (DAS 252.110). The unavoidable costs of an onerous contract are the minimum costs that must be incurred to dispose of the contract, i.e. the lower of the costs of meeting the obligations and the fees or penalties for failing to meet the obligations (DAS 252.405).

The costs of meeting the obligations of a contract consist of (a) incremental costs and (b) an allocation of other costs directly related to meeting the obligations of a contract (DAS 252.405). For a contract for services to be performed, these include, for example, the costs of labour or materials, as well as attributable depreciation costs of tangible fixed assets used in the performance of the contract. For an onerous lease (e.g. of an office building) recognised as an operating lease, the incremental costs consist of the remaining periodic rent until the end of the non-cancellable contract period, taking into account any sublease revenue. Attributable costs directly related to meeting the obligations of the contract may in this case consist of contract management costs, a specific portion of necessary maintenance and restoration costs, cleaning costs and insurance costs.

If an entity has an onerous contract, a provision must be recognised for the negative difference between the performance to be received by the entity after the reporting date and the counterperformance it is to provide after the reporting date (DAS 252.404 and 405).

If a contract can be cancelled without a requirement to pay compensation or a penalty to the other contracting party, no obligation exists. If such a contract is onerous, no provision may be recognised for it (DAS 252.406).

Long-term contracts for the provision of goods or services where the related costs have increased or selling prices have fallen may have become loss-making. For onerous contracts, a provision must be recognised in the amount of the goods or services still to be delivered in the future for which a loss is incurred. No provision is recognised for contracts for the supply of goods that are profitable but have a lower margin in relation to other contracts.

Example: Onerous lease (1)

Due to a restructuring, a company is relocating its production site. The non-cancellable part of the lease for the old site continues for another four years. Based on current market conditions, the company expects to recover 40% of the annual rental costs of 1 million through subleasing. The company has not yet taken concrete action to sublease the production site.

The non-cancellable lease constitutes an onerous contract for the company, which means that a provision must be recognised under DAS 252.404. As the potential revenues are too uncertain, they cannot be taken into account when determining the amount of the provision. Consequently, a provision of 4 million is recognised (assuming that the effect of the time value of money is not material).

Example: Onerous lease (2)

In the case of the company in the previous example, agreement was reached with an event organiser on a sublease (at 400,000 a year). All that remains to be done is to draw up a formal contract between the two parties.

Under DAS 252.308, future events that may be significant to the amount required to settle obligations must be taken into account in determining the amount of the provision if there is sufficient objective evidence that those events will occur. In cases where agreement has been reached with the event organiser on the sublease and only a formal contract remains to be drawn up between the two parties, or where there is otherwise sufficient objective evidence that the loss of the non-cancellable lease will probably be mitigated, the expected sublease revenues are taken into account in determining the amount of the provision. A provision for the onerous lease of 2.4 million is then recognised (assuming that the effect of the time value of money is not material).

Example: Provision for late delivery penalties

Company A BV entered into a sales contract with one of its main customers on 1 February of year 1. Under this contract, it was agreed that 100 units of a particular product would be delivered by 1 February of year 2 at a fixed price of 10 each. The production costs per unit are 9. If the products are delivered more than 10 days late, a discount will be provided to the customer of 50% per product that is delivered late. When entering into the sales contract, A had the capacity and the intention to produce and deliver the 100 units on time. However, at the end of year 1, A can only deliver 80 units and only 10 more are expected to be delivered before 1 February of year 2 due to production constraints. As a result, A expects the remaining 10 units to be delivered at the reduced selling price of 5 (A's financial year equals a calendar year).

The total revenues under the sales contract will be 950 (= (90 x 10) + (10 x 5)) and the total costs will be 900 (= 100 x 90). It can be concluded that the contract as a whole is profitable. However, on the reporting date, A expects to deliver 10 units late and make a total loss on them of 40 (= (10 x 5) - (10 x 9)) and to deliver 10 units on time and make a profit on them of 10 (= (10 x 10) - (10 x 9)). Must a provision be recognised for the loss expected on the 10 units that are expected to be delivered late?

Yes. A provision amounting to 30 (= 40 - 10) must be recognised for the loss expected from the obligations of the contract as a whole. This is because the revenue from the sale of 80 units amounting to 800 has already been recognised in year 1 and a profit of 80 has been recognised in that year. If A is able and expects to reduce the loss by purchasing replaceable products and delivering them before 1 February of year 2, the size of the provision must be adjusted to reflect the expected loss.

Now how should it have acted if A knew from the start of the sales contract that it would not be able to deliver on time? Under these circumstances no provision must be recognised, as it relates to revenue recognition. If A expects to sell 100 units at an average price of 9.50 (= 950 / 100) each, then revenue of 9.50 each must be recognised instead of 10 each.

In summary, it can be concluded that in both situations the total realised profit on the contract (sale of 100 units) is 50. The following shows schematically for both situations in which period and for which amount revenue recognition takes place.

			Recognition in year 1	
Situation	**Revenue**	**Costs**	**Addition to provision**	**Total profit or loss**
Company A expects to deliver on time when entering into the contract	800 (= 80 x 10)	720 (= 80 x 9)	(30)	50
Company A expects to be unable to deliver 10 units on time at the outset	760 (= 80 x 9.50)	720 (= 80 x 9)	-	40
Difference	40	-	(30)	10

Situation	Revenue	Costs	Recognition in year 2 Withdrawal from provision	Total profit or loss
Company A expects to deliver on time when entering into the contract	150 (= 10 x 10 + 10 x 5)	180 (= 20 x 9)	30	-
Company A expects to be unable to deliver 10 units on time at the outset	190 (= 20 x 9.50)	180 (= 20 x 9)	-	10
Difference	(40)	-	30	(10)

An onerous contract is an indication of impairment of the assets involved in that contract. Before recognising a provision for an onerous contract, the entity must test whether these assets are impaired (DAS 252.407). For this, see Chapter 10.

16.7.3 Warranty provisions

A warranty provision must be recognised if expenses may arise because products delivered or services rendered are not of the quality agreed (DAS 252.408). The provision is recognised for the best estimate of the expenses to be reimbursed for products sold or services rendered before the reporting date. This means that it is not allowed to measure this provision using a dynamic method under which, for example, a fixed percentage of revenue is added to the warranty provision each year. At each reporting date, it will be necessary to estimate the expected warranty costs for products sold or services rendered before the reporting date (static method).

Such a warranty provision constitutes a legal obligation if the products delivered or services rendered are not of the quality agreed. But even if the entity, by way of service, reimburses costs for products delivered or services rendered, without this being legally enforceable, and this policy of the entity is generally known and customary, a warranty provision must be recognised as a constructive obligation exists (DAS 252.408). In the presentation in the financial statements, provisions for legally enforcable warranty obligations and for warranties provided by way of service may be aggregated.

Example: Warranty provisions

Warranty costs are expected to be incurred on washing machines sold in large numbers, as a one-year warranty is provided for manufacturing defects. Based on empirical figures, the company estimates that there is a 55% chance of warranty costs being nil, a 40% chance of warranty costs amounting to 1 million and a 5% chance of warranty costs amounting to 20 million. This last figure has to do with a manufacturing defect that compels the company to take back all washing machines sold.

A warranty provision must be recognised as there is a legal obligation (DAS 252.408). When determining a provision to cover a large number of similar liabilities, the amount of the provision is estimated using the weighted average of the possible outcomes (DAS 252.304). A warranty provision is therefore recognised in the amount of 1.4 million (= 40% of 1 million + 5% of 20 million).

16.7.4 Provisions for claims, disputes and litigation

Provisions for claims, disputes and litigation must be recognised when it is probable that the entity will be ruled against in proceedings (DAS 252.409).

Provisions for claims, disputes and litigation are also subject to the conditions of DAS 252.201. This means that such a provision is recognised if it is probable that the entity will be ruled against in proceedings and if a reliable estimate of the amount of the obligation can be made. This will not always be possible in practice, as the outcome of proceedings is often difficult to estimate. Nevertheless, even then, an attempt will have to be made to estimate the amount of the obligation as reliably as possible, based on the opinion of the lawyers, the entity's historical experience and actions (e.g. settlement proposals) the entity intends to take in the proceedings.

If the conditions for recognising a provision are met, it must be recognised at the best estimate of the amount for which the obligation can be settled. The provision also includes the legal costs.

If the amount for which the obligation can be settled cannot be determined with sufficient reliability, no provision must be recognised and the obligation must only be disclosed in the notes. For this, see Chapter 20.

In the case of provisions for claims, disputes and litigation, in highly exceptional cases presentation of a movement schedule or a description of the nature of the provision may seriously prejudice the entity's position in the dispute. Although the entity need not provide that information if that is the case, it is in fact required to disclose the general nature of the dispute (DAS 252.505).

Example: Claims (1)

A claim of 10 million has been filed against a company. The company's lawyer estimates the chance of the claim being fully allowed by the court at 60%, the chance of the claim being allowed for a higher amount at 20% and the chance of the claim not being allowed at all also at 20%.

Since there is a 60% chance of the claim being fully allowed by the court, it is probable that the company will be ruled against in the proceedings (DAS 252.409). When determining a provision for an individual case, the outcome with the highest probability is usually the best estimate of the amount of the obligation (DAS 252.305). A provision of 10 million must therefore be recognised.

Example: Claims (2)

A claim of 30 million has been filed against a company, which considers it probable that an outflow of resources will occur because of this claim. The company estimates that the claim will have to be settled for at least 1 million. The company considers an amount of 5 million a reasonable settlement value as it is confident that the amount will not exceed 10 million, which is confirmed by external experts.

The best estimate of the amount for which the obligation can be settled is 5 million, so a provision of 5 million must be recognised.

Example: Claims (3)

A claim of 30 million has been filed against a company, which considers it probable that an outflow of resources will occur because of this claim. The company estimates that the claim will have to be settled for at least 1 million. However, the company is otherwise completely unable to make a reliable estimate of the amount of the provision. It therefore considers that a best estimate, other than the minimum position, cannot be responsibly made. This impossibility is confirmed by external experts.

The provision must be recognised on the balance sheet for 1 million. Under DAS 252.508, it is adequately disclosed that the claim risk is only partially provided for because its amount cannot be determined with sufficient reliability.

Example: Claims (4)

A claim of 30 million has been filed against a company, which considers it probable that an outflow of resources will occur because of this claim. However, the company is completely unable to make a reliable estimate of the amount of the provision. It therefore considers that a best estimate cannot be responsibly made. This impossibility is confirmed by external experts.

Recognising a provision is not permissible. The notes must disclose the claim and explain that the amount of the obligation cannot be determined with sufficient reliability (DAS 252.409 and 508). This is a contingent liability that must be disclosed in the notes (DAS 252.509). See also Chapter 20.

16.7.5 Provisions for cleaning up existing environmental pollution

The recognition of a provision for the clean-up by the entity of existing environmental pollution depends on (DAS 252.410):

- the relevant legislation in the country where the environmental pollution occurs;
- the entity's policy on cleaning up existing environmental pollution.

If the entity's policy is to clean up any existing environmental pollution as soon as legislation requires it to do so, a provision for the clean-up costs expected must be recognised from the time it is virtually certain that such legislation will come into force (DAS 252.411).

Example: Environmental pollution (1)

Future soil remediation costs are expected abroad for the remediation of already contaminated soil in connection with a committee's recommendation to the Minister to tighten the environmental legislation in the relevant country. Before the preparation of the financial statements (but in the new financial year), the recommendation has been included in a bill yet to be debated by the parliament of the relevant country. The entity's policy is to clean up existing environmental pollution as soon as legislation requires it to do so. A provision for future expected soil remediation costs must be recognised from the time it is virtually certain that the tightened environmental legislation will come into force (DAS 252.411). As the bill is yet to be debated by parliament, no provision may be recognised as it is not yet virtually certain that the tightened environmental legislation will come into force. Suppose that as at the reporting date the proposed environmental legislation has been debated by parliament and as at reporting date it is virtually certain that the tightened environmental legislation will come into force, then a provision must be recognised as at the reporting date.

If the entity has a generally known policy that any existing environmental pollution will be cleaned up, even if the laws of the relevant country do not require it to do so, then a provision for the clean-up costs expected must be recognised from the time the pollution occurs (DAS 252.411).

Example: Environmental pollution (2)

Future soil remediation costs are expected for remediating already contaminated soil abroad. There is no legal duty to clean up in that country. However, the company has a publicly known policy (confirmed by similar cases in the past) of remediating the soil it has contaminated.

The company has a generally known policy that any existing environmental pollution will be cleaned up even if the law does not require it to do so (DAS 252.411). A provision for future soil remediation costs expected must therefore be recognised from the time the pollution occurs. In such a situation, a constructive obligation exists.

As with provisions for claims, disputes and litigation, in practice it is often difficult for provisions for the clean-up of existing environmental pollution to make a reliable estimate of the amount of the obligation. In that case, independent experts must usually be engaged to provide the most reliable estimate of the costs that will be associated with cleaning up the environmental pollution. If the amount for which the obligation can be settled cannot be determined with sufficient reliability, no provision must be recognised and the obligation must only be disclosed in the notes. For this, see Chapter 20.

16.7.6 Provisions for disposal obligations

Under laws and regulations in force in the European Union, applicable in the Netherlands and other European countries, entities (producers, importers and/or market participants) can be held responsible and liable for the costs of disposing of products placed on the market at the end of their lives. These laws and regulations raise a number of specific reporting aspects with regard to recognising the costs arising from these disposal obligations. An example of these regulations is the Regulations on electrical and electronic equipment waste management. This regulation was introduced in the Netherlands in 2004 and became effective in 2005.

The reporting issues that arise with such disposal obligations include:

- When is a provision recognised for a disposal obligation if the obligation depends on the market share in a given year?
- When is a provision recognised for a disposal obligation if the obligation arises from the production or marketing of new products?
- How is participation in a disposal fund taken into account when recognising the provision for disposal obligations?

If and to the extent that an entity is liable for disposal costs based on its market share in any year, a provision must be recognised in that year for the share of estimated disposal costs related to the entity's market share of that year (DAS 252.428). An example is the obligation of disposal costs associated with historical consumer waste (put on the market before 13 August 2005) under the Regulation on electrical and electronic equipment waste management.

If and to the extent that the production or marketing of new products results in a disposal obligation, a provision must be recognised at the time of manufacture or marketing, respectively, of the relevant products. An example is the obligation for producers to dispose of new consumer waste they produced (and put on the market after 13 August 2005) under the Regulation on electrical and electronic equipment waste management.

If the disposal obligation arises at the time the product is manufactured or marketed, the entity must recognise a provision at the time of manufacture or marketing, respectively, of the relevant products. The costs necessary to settle the obligation are recognised as part of the carrying amount of the product.

Participation in a disposal fund
A disposal fund is defined as follows (DAS 252.110):

- the fund receives contributions from the participants, to be used by the fund to settle or reimburse future disposal obligations;
- the fund is independent of the participants;
- the participants do not have control, joint control or significant influence over the fund; and
- the participants are generally not entitled to any surplus in the fund.

If an entity participates in a disposal fund and makes payments to the fund to reimburse or settle disposal obligations, it must be determined whether the payment results in settlement of the entity's legal obligation (DAS 252.428):

- If the payment does not lead to legal or contractual settlement of the obligation, the entity must recognise the right to reimbursement from the fund as a separate asset on the balance sheet up to a maximum of the entitlement to the assets in the disposal fund available to settle the entity’s obligations.
- If and to the extent that the payment does result in legal or contractual settlement of the obligation, it must no longer be recognised on the balance sheet.

The assessment of whether an entity has settled its obligation is made in accordance with DAS 115.109-111.

16.7.7 Provisions for government levies

Government levies are levies imposed by the government, other than income taxes and other than fines. Government means local authorities, state governments or international authorities as well as government bodies and similar authorities (DAS 252.110). With government levies, the situation may arise that the levy base is based on past activities while the levy is due depending on the fulfilment of a condition or conditions in a later reporting period. The question then is to which reporting period the levy must be allocated or at what point a liability must be recognised on the balance sheet.

The Dutch Accounting Standards Board indicates that a government levy can be recognised in one of two ways (DAS 252.429):

- in the period to which the government levy relates; or
- when all conditions for the government levy are met.

The entity must explain the method used in the notes to the financial statements (DAS 252.429).

Example: Government levies

Company A's financial year ends on 31 December of year 1. A owes a government levy in one of the countries in which it operates as soon as it generates revenue in year 2. The first revenue in year 2 is generated on 3 January of that year. The amount of the levy is calculated as a percentage of revenue for year 1. The question now is at what point A must recognise a liability: Already during year 1, or only on 3 January of year 2.

If the government levy is recognised in the period to which it relates, A recognises a liability during year 1 and charges it to profit or loss (in proportion to the revenue for year 1), whereas strictly speaking the liability only arises on 3 January of year 2. The accrual principle takes centre stage in this recognition method. If the government levy is recognised when all conditions for the levy are met, A does not recognise a liability (charged to the profit or loss of year 2) until 3 January of year 2. This is the approach prescribed under IFRS (IFRIC 21), which involves a strict liability approach.

16.8 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

Pursuant to Article 2:396 NCC, small entities are exempt from the breakdown of provisions according to the nature of the obligations and losses they are intended to cover (Articles 2:374(3) and (4) NCC). Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

16.9 Significant differences from IFRS

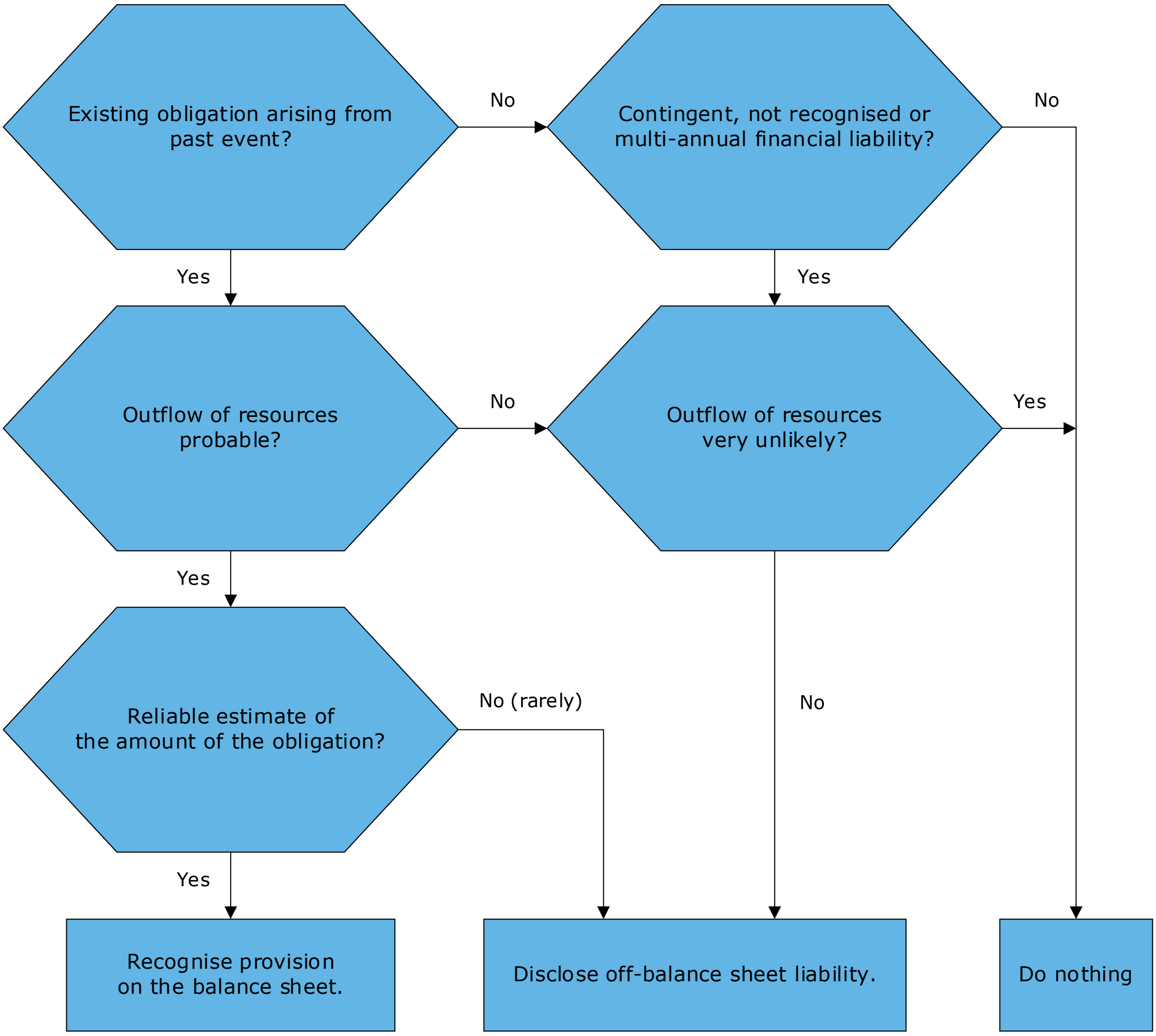
Reimbursement by a third party
In some cases, an entity can recover all or part of the expenditures of settling a provision from a third party, for example on the basis of an insurance contract, an indemnity or guarantees. In such a situation, IAS 37 provides that such reimbursement is recognised only if it is virtually certain that it will be received upon settlement of the obligation. DAS 252, by contrast, requires such reimbursement to be recognised if it is probable that it will be received upon settlement of the obligation. Consequently, under DAS 252 such reimbursement will be recognised on the balance sheet at an earlier stage than under IAS 37.

Discount rate
IFRS also provides that risks already taken into account when estimating future expenditures cannot be included again in the level of the discount rate. Whereas the DASB indicates that the market interest rate as at the reporting date of high-quality corporate bonds is the most appropriate interpretation, IFRS provides that, in addition to the market valuation of inflation, risks specifically related to the liabilities must also be included. Although IFRS seems to leave more room for a more company-specific determination of the discount rate, IFRIC expects that the entity's own credit risk will usually not be included in the discount rate. Without this component, this is effectively in line with the frameworks of DAS 252.

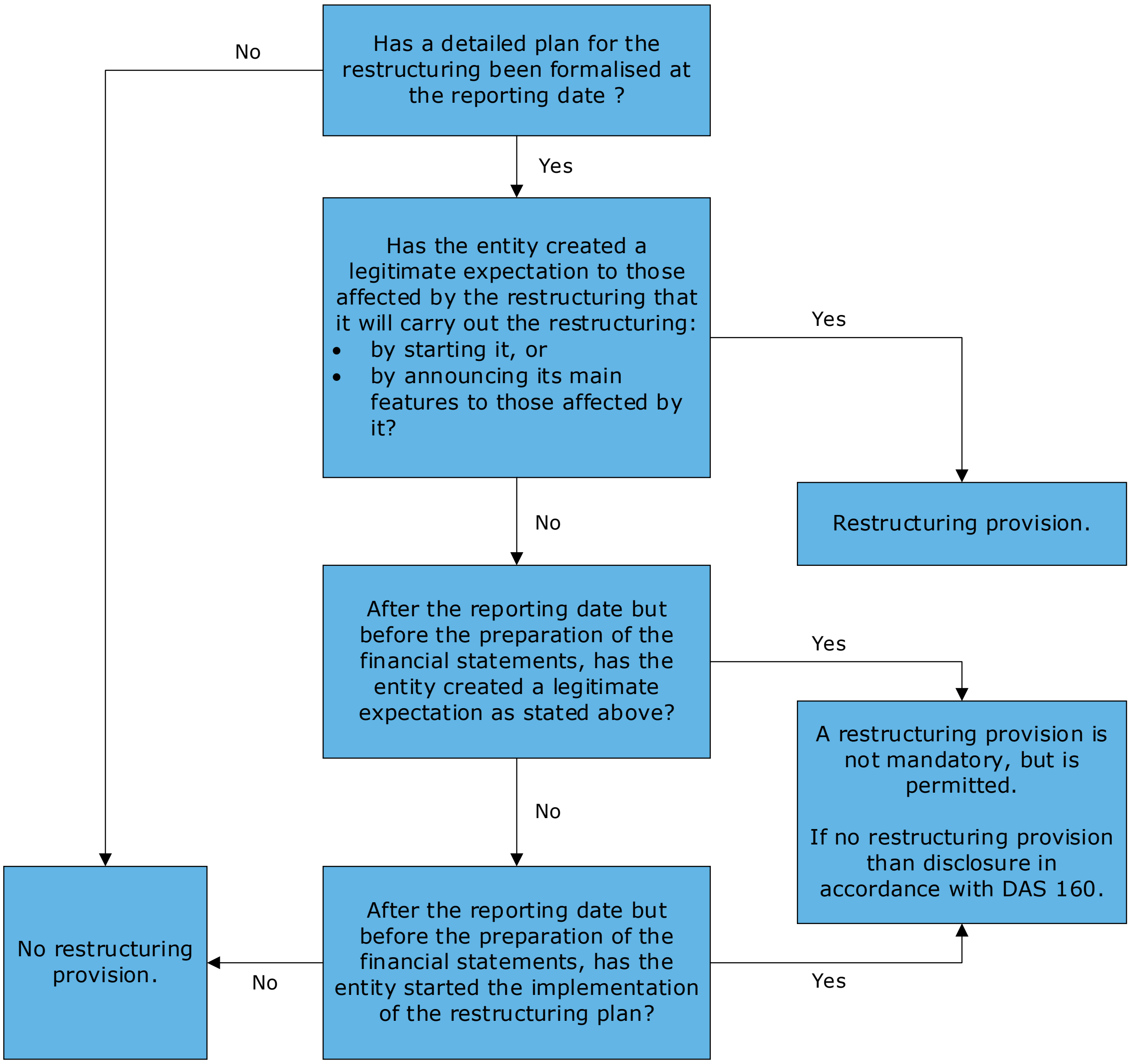
Restructuring provisions
Under IAS 37, for recognising a restructuring provision at the reporting date the restructuring must have started or its main features have been announced. DAS 252 also offers the possibility of recognising a restructuring provision if only after the reporting date but before the preparation of the financial statements the entity creates a legitimate expectation to those affected that the restructuring will be carried out. In that case, the entity has the choice of whether or not to recognise a provision on the balance sheet (DAS 252.416).

Government levies
IFRIC 21 prescribes that a liability is recognised when all conditions for the government levy are met. DAS 252 provides that the government levy may also be recognised in the period to which the government levy relates (DAS 252.429).

Annex 1. Diagram of the recognition of provisions and contingent liabilities (extracted from DAS 252)



Annex 2. Diagram of the formation of a restructuring provision



17 Income taxes

17.1 Introduction

This chapter deals with the recognition of income taxes. Income taxes include all domestic and foreign taxes levied on taxable profit. Taxable profit is the profit for the reporting period, determined according to tax rules, on which income tax is payable or recoverable. Tax loss is negative taxable profit on which tax is recoverable.

A distinction is made in the financial statements between the recognition of taxes payable or recoverable (i.e. current) for a reporting period (see paragraph 17.2), deferred taxes resulting from temporary differences (see paragraph 17.4) and deferred taxes resulting from carry-forward of losses (see paragraph 17.5). Uncertain tax positions are taxes payable and/or receivable as well as deferred taxes for which it is uncertain whether the tax authorities will agree to (the intended manner of filing) the tax return. For this, see paragraph 17.3.

Pillar 2 – income taxes
This chapter also applies to minimum taxes resulting from tax legislation adopted or announced that aims to implement the ‘Pillar Two model rules’ published by the Organisation for Economic Cooperation and Development (OECD).

The main features of these OECD 'Pillar Two model rules' are as follows:

a. The goal is for large multinational groups to pay a minimum amount of tax on income in each jurisdiction where they operate.
b. To this end, a system of additional taxes is applied that results in the total amount of income taxes to be paid on the profit in each jurisdiction being at least the minimum rate of 15%.
c. Primarily, the ultimate parent entity of a group is required to pay the additional tax, in the jurisdiction where it is established, on the profits of its subsidiaries that are taxed at less than 15%.

In the Netherlands, the 'Pillar Two model rules' have been included in the bill 'Minimum Tax Act 2024' (*Wet minimumbelasting 2024*). This bill was passed by the Senate on 19 December 2023 and published in the Dutch Government Gazette on 27 December 2023. Therefore, the Dutch legislation on Pillar 2 income taxes was enacted on 27 December 2023, and substantively enacted on 19 December 2023. The law has come into effect as of 31 December 2023 and applies to financial years starting on or after 31 December 2023, thus (in most situations) from financial year 2024. The law applies to multinational and domestic groups with a (consolidated) group turnover of more than EUR 750 million.

Primarily, the ultimate parent entity of a group is responsible for Pillar 2 income taxes, but the parent entity can also assign this task to another group entity. If the entity responsible for the Pillar 2 income taxes (partially) recharges them to other group companies, the group companies will classify this recharge as income tax expense in their profit and loss account. The group companies do not recognise any income tax expense in their profit and loss account if they do not receive a recharge. Both the entity responsible for Pillar 2 income taxes and the recharged group companies disclose the method of recharging Pillar 2 income taxes (see paragraph 17.9).

For the financial statements, there are already disclosure requirements for the financial year 2023, the year in which the legislation was substantively enacted. These are included in DASB Statement 2023-14 'Draft paragraphs on Pillar 2 income taxes'. In addition, from the financial year 2024, the Pillar 2 income taxes payable for that financial year must be accounted for in the profit and loss account. As an exception to the requirements in this chapter, an entity should not recognise deferred tax assets and liabilities related to Pillar 2 income taxes (dDAS 272.102a). It is expected that the draft paragraphs included in this statement will be definitively established in the first quarter of 2024. For a more detailed description, refer to paragraphs 17.1, 17.4 and 17.9.

17.2 Recognition of taxes payable and recoverable for the reporting period

Taxes payable in respect of current and prior reporting periods, to the extent not yet paid, are recognised as a liability. If more has been paid for these reporting periods than the amount due for those reporting periods, this difference is recognised as a receivable (DAS 272.201). Tax income arising because a loss due to loss carry-back results in a refund of taxes paid for a prior period is recognised as a receivable (DAS 272.202). As these taxes are payable or receivable on the reporting date, they are referred to as current taxes.

Under Dutch tax rules, corporate income tax losses may be offset against taxable profits for the previous reporting period if certain conditions are met. When there is no possibility, or no longer a possibility, to carry back losses, these tax losses may remain available for setting off against tax profits to be realised in the future. Until 2021, tax losses could be carried back one year and forward six years. From 2022, tax losses above EUR 1 million will only be eligible for set-off against up to 50% of taxable profits, after that taxable profit has been reduced by the aforementioned amount. This limitation applies to both loss carry-forward and loss carry-back. On the other hand, the time limitation in respect of loss carry-forward has been done away with. The period for loss carry-back remains one year. See also the explanation in paragraph 17.5.

In the case of losses available for carry-forwards, a deferred tax asset is recognised if certain conditions are met (see paragraph 17.5). Thus, there is no current right to a receivable here because there is setting off against taxable profits that may be realised in the future. Hence the deferred (more precisely: conditional) nature of this tax asset (more precisely: right of offset).

17.3 Uncertain tax positions

Uncertain tax positions are taxes payable and/or receivable as well as deferred taxes for which it is uncertain whether the tax authorities will agree to (the intended manner of filing) the tax return. A tax authority can be a court in addition to the Tax Administration. The standards stipulate that (deferred) tax assets and liabilities (DAS 272.402a):

- should be measured in accordance with the tax return if it is probable (i.e. 'more likely than not') that the tax authorities will agree to the return; and
- if the latter is improbable, the measurement should be based on the best estimate of the different tax amount compared to the (intended) tax return.

Therefore, no distinction is made between the recognition of uncertain receivables and uncertain liabilities. The measurement should also be based on the assumption that the tax authorities have all relevant information and that testing of the uncertain tax position will be done by the tax authorities.

If an uncertain tax position affects both taxes currently payable or receivable and deferred taxes, the uncertain tax position should be recognised and measured consistently for all these tax positions (DAS 272.402a).

Example: Uncertain tax liability

A company has provided a loan to a foreign group entity (in country A) with what it believes to be an effective interest rate at arm's length. The borrowing costs are considered a deductible item in this foreign group entity's return. The Tax Administration of country A has lodged an objection to the level of the interest rate and imposed an adjustment of 1,000,000. Despite several filed objections, the Tax Administration is not budging from its position. The company has decided to take the dispute to court. Tax jurisprudence in country A shows that, in the preliminary stage of the case, the court will explore whether the parties are willing to settle. Based on advice from tax advisers in country A and on similar cases, the company's management concludes that the likelihood that the Tax Administration will agree with the return, is nil. Although the company believes it has a strong substantive position, it is willing to settle up to 50% of the adjustment amount, i.e. 500,000. This amount is also considered the best estimate of the final amount to be paid. In that case, this best estimate of 500,000 is recognised on the balance sheet. The uncertainty of a possibly different outcome is disclosed.

Example: Uncertain tax asset

A company has taken a defensible tax position in its corporate income tax return on intercompany transfer pricing that it expects to be challenged by the Tax Administration. If the recognition in the return is accepted, it will result in a tax refund of 100,000. Based on advice from its tax adviser and on similar cases, the company's management concludes that the probability of the Tax Administration agreeing to the return is more than 50%. In that case, the full amount of 100,000 is recognised on the balance sheet. The uncertainty that the return may not be accepted is disclosed.

17.4 Deferred taxes; recognition of temporary differences

General approach
For the recognition of deferred taxes, a balance sheet approach is followed. Under this approach, the basis for entry of deferred taxes are the temporary differences between carrying amounts in the balance sheet of the financial statements and tax bases of assets or liabilities. At the end of each financial year, the extent to which a deferred tax item is applicable is determined on the basis of the differences apparent at the time. This therefore puts the balance sheet at the centre and the effective tax rate in profit or loss is the result. The temporary differences to be distinguished are discussed in more detail below.

Exception for Pillar 2 income taxes
As an exception to the requirements in this chapter, an entity should not recognise deferred tax assets and liabilities related to Pillar 2 income taxes (dDAS 272.102a). This mandatory exception is temporary. However, no end date has been defined.

In doing so, the Dutch Accounting Standards Board has followed a similar exception that applies under IFRS. Under IFRS, given the short timeframe of implementation of the new tax legislation and the time required to (1) determine how to apply the principles and requirements of IAS 12 'Income Taxes' to deferred taxes in connection with the additional Pillar 2 income taxes; and (2) support a consistent application of IAS 12, concluded that it was not feasible to complete these activities before jurisdictions adopt the new tax legislation. According to the Dutch Accounting Standards Board, the same applies to DAS 272 'Income taxes'. However, specific disclosure requirements apply to provide insight into the expected impact of Pillar 2 income taxes, see paragraph 17.9.

Taxable temporary differences
Taxable temporary differences are deemed to result in tax payable on future realisation or settlement of the asset or liability for those future reporting periods. A deferred tax liability should be recognised for all taxable temporary differences (DAS 272.301).

Deductible temporary differences
Deductible temporary differences are deemed to result in tax recoverable on future realisation or settlement of the asset or liability for those future reporting periods. A deferred tax asset should be recognised for all deductible temporary differences up to the amount it is probable that taxable profit will be available for set-off (DAS 272.306).

This means that, in general, deferred tax assets should be recognised where there are deferred tax liabilities. This is understandable, since, if and insofar as there are deferred tax assets, they will result in future in the deferred tax liabilities on balance not leading to payment of tax. However, this is on condition that the taxable temporary differences concern the same tax authorities and the same fiscal unity as the deductible temporary difference, and that these (DAS 272.309):

- expire in the same period as the expected reversal of the deductible temporary difference; or
- expire in reporting periods in which a resulting tax loss can be offset by carry-forward or carry-back.

Incidentally, this excludes taxable temporary differences due to revaluation (DAS 272.310). This lacks a justification from the Dutch Accounting Standards Board, but in our opinion this restriction cannot be separated from the fact that the realised part of the revaluation can still be recognised via the profit and loss account (DAS 212.415), thereby removing the 'taxability' of the temporary difference. After all, in that case the depreciation charge in the financial statements will on balance equal the tax depreciation charge based on historical cost. IFRS has no such restriction in the recognition of deferred tax assets, but under this standard, the realised part of the revaluation may also not be taken to the profit and loss account but must be recognised within equity. As a result, over the future depreciation period of the revalued asset, a positive difference will arise between the taxable profit or loss and accounting profit or loss and can therefore rightly be referred to as a *taxable* temporary difference because of that future difference.

Temporary differences in business combinations
In business combinations, the purchase price is allocated to the identifiable assets and liabilities based on their fair value. If the tax base is not adjusted or not adjusted equally, taxable or deductible temporary differences arise. For example, if in a business combination in the form of a share transaction in the financial statements the carrying amount of an asset is increased to fair value, but the carrying amount for tax purposes is maintained at the historical cost of the acquired entity, a taxable temporary difference arises that results in a deferred tax

on the recognition of a business combination is measured in accordance with the provisions of DAS 272 on income tax. These deferred taxes impact the amount of goodwill (DAS 272.303). See also paragraph 31.3.4.

Temporary differences; group entities, foreign non-autonomous entities, associates and joint ventures
When the carrying amount of investments in group entities, foreign non-autonomous entities, associates and joint ventures differs from the carrying amount for tax purposes, this is also a temporary difference (DAS 272.315). This occurs, for example, in the case of undistributed profits, a change in exchange rates and in the case of an impairment loss. Also, the temporary difference in the consolidated financial statements may differ from that in the company-only financial statements, for example if these interests are not recognised at net asset value in the company-only financial statements.

No deferred taxes (assets or liabilities) are recognised for interests covered by the tax participation exemption (see also below under 'Other temporary differences'). However, in the event of liquidation of such an interest, a (deferred) receivable from the tax authorities could arise.

For taxable temporary differences relating to investments in group entities, foreign non-autonomous units, associates and joint ventures, a deferred tax liability is recognised unless (DAS 272.316):

- the parent entity, investor or partner is able to determine the timing of the reversal of the temporary difference; and
- it is probable that the temporary difference will not be reversed in the foreseeable future.

The latter is the case if the parent entity can determine the dividend policy of its group entity. Indeed, by determining the time at which dividend distributions are made, the parent entity can determine the time at which temporary differences concerning that group entity expire (the differences being not only those relating to undistributed profits, but also any foreign currency translation differences (DAS 272.317).

For deductible temporary differences associated with investments in group entities, foreign non-autonomous units, associates and joint ventures, a deferred tax asset is recognised only where it is probable that (DAS 272.318):

- the temporary difference will be reversed in the foreseeable future; and
- there will be taxable profit available for offsetting.

Revaluation of assets
A taxable temporary difference also arises on revaluation of assets, to the extent this is not taken into account for tax purposes. The law does not require the recognition of a deferred tax liability or asset. This legal possibility is based on what is contained in Article 2:390(5) NCC. This article requires that the notes explain whether and how the impact of taxes on equity and profit or loss is taken into account in connection with the revaluation. It can be inferred that the law does not require the recognition of a deferral according to the legislator. However, the Dutch Accounting Standards Board expresses a strong preference for recognising a deferred tax liability or asset in relation to a revaluation (DAS 272.304).

Other temporary differences
Other temporary differences are deemed not to give rise to tax payable or recoverable on the future realisation or settlement of the asset or liability for those future reporting periods. Due to the nature of these differences, no deferred taxes arise (DAS 272.104). Examples include the settlement of differences covered by the participation exemption, the tax exemption of income or the non-deductibility of expenses. Although this refers to 'other *temporary* differences', it is important to note that differences between carrying amounts in the balance sheet of the financial statements and tax bases of assets or liabilities are generally not an issue here. The other temporary differences, as with permanent differences, result in an effective tax rate that does not correspond to the nominal tax rate.

Applicability of the 'initial recognition exemption'
Under IFRS deferred taxes are not recognised for temporary differences if in a transaction, other than a business combination, at the time of initial recognition of that transaction, neither the accounting profit or loss nor the taxable profit or loss is affected. This is called the 'initial recognition exemption'. It is not clear whether these temporary differences also fall under the 'other temporary differences' referred to in DAS 272.104. We support the view in the literature that the wording of DAS 272.104 is not intended to differ from the 'initial recognition exemption' in a practical sense. The following example illustrates the consequences of applying the initial recognition exemption.

Example: Initial recognition exemption (extracted from IAS 12)

Company A acquires a fixed asset for an amount of 1,000 with an expected useful life of 5 years. The asset has a residual value of nil and will be sold for this amount at the end of the useful life. The corporate income tax rate is 25%. The depreciation costs incurred during the use of the asset are not tax deductible for special tax reasons. When the asset is sold, any gains are not taxable, nor are any losses deductible. During the useful life of the asset, the carrying amount of the asset will be recovered by expected incoming cash flows of the cash-generating unit to which the asset belongs.

Since the carrying amount of the asset will be recovered during the use of the asset, taxable income will arise for an amount of 1,000 and an income tax of 250 (= 1,000 * 25%) will be due. Company A does not recognise the deferred tax liability at initial recognition because it arises from the 'initial recognition exemption'.

The consequence of applying the 'initial recognition exemption' is that the additional tax burden that arises from the non-recognition of the carrying amount of the asset for tax purposes is reflected over the period of use of the asset. After all, in the 5 years after acquisition, the depreciation expense of 200 per year (assuming linear depreciation) will not be recognised for tax purposes, which results in a higher effective tax burden compared to the nominal rate of 50 per year (= 250 / 5 or 200 * 25%). We believe that this spread of the higher tax burden over the period of use better complies with the insight requirement than immediately recognition of a tax expense of 250 at the time of acquisition of the asset.

If the increased effective tax burden is material for the financial statements the additional tax burden is disclosed in the note of the reconciliation between the effective tax rate and the nominal rate (DAS 272.704).

17.5 Deferred taxes; recognition on available loss carry-forwards

Introduction
With available loss carry-forward there is the possibility of recognising a deferred tax asset. When assigning a value to this – or not – the probability of realisation is taken into account in the assessment.

A deferred tax asset is recognised for the carry-forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised (DAS 272.311). The criteria for recognising deferred tax assets due to an available loss carry-forward are the same as for those arising from deductible temporary differences.

Loss carry-forward legislation
Until 2021, tax losses could be carried back one year and forward six years.

From 2022, tax losses above EUR 1 million will only be eligible for set-off against up to 50% of taxable profit, after that taxable profit has been reduced by the aforementioned amount (see also the example below). Incidentally, the remaining loss remains available for offsetting in a subsequent year. This limitation applies to both loss carry-forward and loss carry-back. On the other hand, losses can be carried forward indefinitely. The period for loss carry-back has remained one year.

The amendments also affect the offsetting of losses incurred in financial years commencing prior to 1 January 2022, namely:

- losses incurred in financial years that started before 1 January 2013 can be carried forward under the rules applicable in those years, for up to nine years (i.e. until 2021);
- losses incurred in the 2013 to 2021 financial years can be carried forward indefinitely. However, these losses are affected by the 50% rule to the extent that they are offset against taxable profits for financial years starting on or after 1 January 2022. That limitation also applies to carry-back of a loss incurred in 2022 against taxable profits in 2021.

The legislation obviously has an impact on the recognition of deferred tax assets from loss carry-back. See also the example included at the end of this paragraph regarding the recognition of such a deferred tax asset, where, among other things, the premise is that the time limit for loss carry-forward is unlimited, but where only 50% of taxable profit is eligible for set-off. The measurement of deferred tax assets should be based on the new legislation in all financial statements with a reporting date on or after 21 May 2021. That is, in fact, the date (of the Royal Decree) on which the new legislation was substantially enacted (see paragraph 17.6).

Example: Loss set-off methodology from 2022 onwards

The following tax profits and losses apply to Company A:

- In year 1, a loss of EUR 10 million;
- in year 2 a profit of EUR 5 million.

The following taxable profit in year 2 is eligible for loss set-off: EUR 1 million + EUR 2 million (= 50% of EUR 5 million - 1 million). The taxable amount for year 2 is then EUR 2 million (= EUR 5 million - EUR 3 million). Of the loss incurred in year 1, EUR 7 million (= EUR 10 million - EUR 3 million) remains. This remaining loss can be carried forward indefinitely over time. But even then the restriction of the 50% rule applies.

Estimating probability of realisation
Clearly, estimating the probability of realising the right to carry forward losses is not straightforward. This is because the trigger for this estimate is the fact that (tax) losses were incurred in the past. That fact in itself, therefore, raises the question of whether there will be sufficient taxable profit in the future. This therefore means that it is recommended that the cause of the losses incurred be examined. For example, were they incidental losses or basically structural losses? If the latter is the case, it is also relevant whether or not measures have since been taken to end the loss-making situation.

Of course, a positive assessment of the future is not in itself sufficient for the inclusion of a deferred tax asset on the balance sheet. All circumstances must be taken into account when assessing the probability of realisation. Meeting the 'probability of realisation' criterion requires that it can be substantiated that sufficient taxable profits will be realised in the future.

Incidentally, not (yet) recognising a deferred tax asset does not implicitly mean that there is already significant uncertainty about the company's going concern status.

Impact of taxable temporary differences on probability of realisation
If there are sufficient taxable temporary differences concerning the same tax authority and the same fiscal unity in the period until the loss carry-forward or set-off expires, deferred tax liabilities will not result in tax payment where the same fiscal unity has deferred tax assets. This means that the probability criterion is always met up to the amount of deferred tax liabilities arising from temporary differences. As discussed in paragraph 17.4, this also applies to deferred tax assets arising from deductible temporary differences. Only if the loss carry-forward period is time-limited may the probability criterion permit taking only limited account of the deferred tax liability. Incidentally, as mentioned earlier in paragraph 17.4, DAS 272.310 explicitly states that deferred tax liabilities from revaluation should not be taken into account here. However, see also what is noted below regarding the possibility of creating taxable profits.

Insufficient taxable temporary differences
If there are insufficient taxable temporary differences, as indicated above, what matters is the estimate of future taxable profits in the period up to the time the loss carry-over or set-off expires. The fact that there is available loss carry-forward is a strong indication that there may not be sufficient future taxable profits. There must then be sufficiently strong evidence that taxable profits will still be available in the future (DAS 272.312).

Possibility of creating taxable profit
The assessment should take into account the fact that in many cases an entity has the possibility to create taxable profit in the reporting period in which the available loss carry-forward is to be realised or the tax credits are to be utilised. For example, if it is a real option for the entity to convert hidden reserves into taxable profit by selling assets outside the fiscal unity, this is taken into account in the assessment of probability.

Estimate to be assessed on each reporting date
An estimate of probability of realisation must be made on each reporting date (DAS 272.314). It will be clear that if there was another loss for the past year, this will have a negative impact on the re-estimation of the possibility of

realising future profits. The reverse also applies, of course. So if the then past year has seen what appears to be a structural improvement in profit or loss, this will have a positive impact on the estimation of the possibility of generating sufficient taxable profit in the future. This may even prompt the recognition of a previously unrecognised deferred tax asset**.**

Example: Recognition of deferred tax asset arising from loss carry-over

There is an amount of loss carry-forward of 800. At a corporate income tax rate of 25% and with measurement at face value, the deferred tax asset arising from loss carry-forward is a maximum of 200 (if sufficient future taxable profits are available). There is also a deferred tax liability of 300 from temporary differences in the amount of 1,200. This deferred tax liability expires in 20 years at equal amounts (15) per year. The recognition of deferred tax assets is elaborated below for a limited and an unlimited period of loss carry-forward in turn.

The period for loss carry-forward is six years:

In this case, the loss carry-forward is realised with certainty for 90 (= 6 x 15), even if in the future (apart from the reversal of temporary differences) the taxable profit is always zero. A deferred tax asset should therefore be recognised for this amount. For the amount of 110 (= 200 - 90), it should be considered whether there is reason to measure it on the basis of the probability that taxable profit will be available within the loss carry-over period.

The period for loss carry-forward is unlimited but only 50% of the taxable profit may be used for carry-over:

If in the future (apart from the reversal of temporary differences) the taxable profit is always zero, the reversal of the temporary differences results in a total taxable loss of 600 (50% of 1,200). The loss carry-forward is thus realised for 150 (= 25% of 600). This means that a deferred tax asset is recognised for that amount. On balance, this leaves a deferred tax liability of 150 (= 300 - 150). This represents the future taxable profit on the reversal of the temporary differences that cannot be offset with the temporary differences (i.e. 25% of 50% of 1,200). For the part of the unused losses not realisable with the temporary differences of 200 (= 800 - 600), it should be considered whether there is reason to measure it on the basis of the probability that taxable profit will be available within the loss carry-over period. In this situation, although the set-off period is unlimited, only half of the tax 'profit potential' of the temporary differences may be used for carry-over.

Unlimited set-off period
Often, with an unlimited set-off period, sufficient taxable profits can be expected to be available in order to account for a deferred tax asset on the maximum loss carry-over. However, this does not alter the fact that even with an unlimited period it must be probable that future taxable profits will be available (DAS 272.311). Situations where this is not the case may relate to, for example, holding entities/fiscal unities that can account for little or no taxable income because the income is not recognised for tax purposes. Again, consider the participation exemption. Dividends received or gains on the sale of a participating interest are then not taxed. Similarly, the absence of strong indications of the availability of future taxable profit when there are recognised tax losses (DAS 272.312, see above), regardless of the length of the set-off period, will have to lead to the conclusion that the criteria for capitalising a deferred tax asset cannot be met.

17.6 Deferred taxes; measurement

Rate
The measurement of deferred taxes is based on the tax consequences of the entity's intended method of realisation or settlement of the relevant items at reporting date (DAS 272.403). This measurement takes place at the most current tax rate. In other words, at the expected rate at the time the deferred tax asset is realised. That means that measurement must be based on the rates that have in fact (substantively) already been enacted on the reporting date (DAS 272.401).

Example: Substantive enactment on the reporting date of tax rates

In the Netherlands, after parliamentary consideration of the Annual Budget, the State Budget and the tax plan, tax rates are legislated to be approved by both chambers of the States General. Suppose the first chamber approves the tax plan for year 2 in December of year 1 but publication in the Government Gazette does not follow until 4 January of year 2. Does this now mean that a substantive enactment has taken place on the reporting date (31 December year 1)?

In this situation, as the parliamentary process is fully completed by 31 December year 1 (including approval of tax rates), we consider that a substantive enactment has been taken on the reporting date. This means that the deferred tax assets at the end of year 1 should be measured at the established rates of year 2.

Now suppose a component of the year 2 tax plan has to undergo an implementation review first. The law envisages an effective date of 1 January of year 3 or 4 but this will have to be ratified by Royal Decree. However, if it is deemed that the law in its current form is not enforceable, it will be amended and resubmitted to parliament. The Royal Decree has not yet been published by 31 December year 1. In this situation, there is no substantive enactment on the reporting date at year-end 1. This situation played out in the 2021 tax plan with regard to the adjustments to the method of tax loss carry-forward (unlimited set-off period where 50% of future annual tax profits are eligible for carry-over, see also paragraph 17.5).

Face or present value
Deferred taxes are measured at either face value or present value (DAS 272.404). The requirement of simultaneous consistency applies to the choice made; all deferred taxes are then measured either at face value or at present value.

Present value
If present value measurement is chosen, this is explained in the notes. Discounting takes place on the basis of net interest (DAS 272.405). Net interest is defined as the interest rate applicable to the entity for long-term loans net of tax based on the effective tax rate. Movements in deferred taxes due to interest accrual should be recognised as tax expense or income (DAS 272.405).

When measured at present value, the relationship between deferrals and the assets and liabilities to which they relate determines the calculation of present value. In many cases, a link can be made to individual assets or liabilities. The calculation of present value should take into account the lives of the assets and liabilities to which the deferrals relate (DAS 272.405). For example, in the case of a measurement difference relating to tangible fixed assets, depreciation in the financial statements and depreciation for tax purposes will make it possible to determine in advance exactly what the future course of that difference will be. Sometimes tax facilities can be used that make it possible for no tax settlement to take place during their life and deferrals to be carried forward to other (mostly new) assets or liabilities. This should be taken into account if it is highly probable that the deferral will be carried forward after the end of their life (DAS 272.405). This may be the case, for example, in the case of demolition and reconstruction of assets of the same nature or sale and purchase of assets with the same economic function in the case of a reinvestment reserve.

On practical grounds, the face value may be applied for short-term deferrals, even if other deferrals are recognised at present value. Indeed, in that case, the difference between the face value and the present value will not be material.

If little or no link can be made to individual assets and liabilities, the likelihood that the deferrals will decrease in total and other relevant factors – such as, in particular, the period over which this is expected to occur – are taken into account (DAS 272.405). Examples include deferrals under tax loss carry-forward or deferrals related to a pension provision under DAS 271.

It is known from practice that there is regularly no specific calculation of the present value of deferred taxes, but that this is determined based on a rule of thumb, with percentages of 20, 15 or 10 regularly occurring. This need not be wrong per se; it could be correct more or less by chance. A calculation will have to substantiate the percentage used.

If the useful life is 'infinite', the present value will be approximately zero. In that scenario, this fact is explained in the notes. This may be the case, for example, for a deferred tax asset on the revaluation of land due to the assumption that the land will not be sold.

Example: Determining present value

An investment in a new machine amounts to 1,000,000. For tax purposes, gains on previously sold machines of 250,000 are deducted from this. The life of the new machine is 10 years and the residual value of the new machine is 100,000. The interest rate is 5.33% and the tax rate 25%.

The net interest rate is therefore 4% (= 75% of 5.33%).

The calculation of the present value of the deferred tax is then as follows:

Year	Depreciation as per financial statements	Depreciation for tax purposes	Lower depreciatio n for tax purposes	Tax due on this	Present value of this tax at a discount rate of 4%
1	90,000	65,000	25,000	6,250	6,010
2	90,000	65,000	25,000	6,250	5,778
3	90,000	65,000	25,000	6,250	5,556
4	90,000	65,000	25,000	6,250	5,343
5	90,000	65,000	25,000	6,250	5,137
6	90,000	65,000	25,000	6,250	4,939
7	90,000	65,000	25,000	6,250	4,749
8	90,000	65,000	25,000	6,250	4,567
9	90,000	65,000	25,000	6,250	4,391
10	90,000	65,000	25,000	6,250	4,222
Total	900,000	650,000	250,000	62,500	50,692
				Face value	Present value
Relative measurement of deferral				25%	20.3%

The example included above shows that a percentage determined according to a rule of thumb of, say, 15 cannot be casually applied, because there is a chance that the deferred tax will be recognised too high or too low.

Furthermore, it can be seen from the example that the relative measurement of the deferral will get closer and closer to the face value with the passage of time. Thus, at the end of year 8, maturity will be only two years. The present value of the deferral will then be EUR 11,788 (= 6,010 + 5,778), which is a relative measurement of 23.6% (= 11,788 / 50,000).

Measurement of deferred tax asset to be assessed on each reporting date
On each reporting date, the carrying amount of a deferred tax asset is reassessed. The carrying amount of a deferred tax asset should be reduced to the extent that it is no longer probable that sufficient taxable profit will be available to realise all or part of the deferred tax asset (DAS 272.406). Once this does become probable again, this reduction will be reversed through the item for taxes. The impairment loss should be shown separately in the profit and loss account or the notes.

17.7 Recognition of taxes in profit or loss or in equity

General
Taxes are recognised as a separate item in the profit and loss account (DAS 272.502 in combination with DAS 272.608). Cases of taxes relating to items recognised directly in equity are an exception to this. In that case, the related taxes are also recognised directly in equity (DAS 272.506). Dividend tax withheld by the entity is therefore recognised directly in equity as part of the dividend. Furthermore, there is an exception where the tax item results from a business combination, since this tax is then recognised in the net asset value of the acquired company and is thus kept off the profit and loss account.

Movements in deferred taxes due to interest additions when deferred taxes are measured at present value should be recognised as tax expense or income (DAS 272.405). The exception is an interest addition to a deferred tax measured at present value that relates to a direct movement in equity (DAS 272.506). An example is an interest addition to a deferred tax liability arising from a revaluation of a tangible fixed asset recognised directly in equity. That interest addition is then also recognised directly in equity, since, in that scenario, these taxes relate to an item (the revaluation) that has been recognised directly in equity.

If there is an impairment of a deferred tax asset, it should be disclosed separately in the profit and loss account or the notes (DAS 272.406).

Change in tax rates or rules
The carrying amount of deferred tax assets and liabilities may change even though there is no change in the related temporary differences. This is due, for example, to (DAS 272.504):

- a change in tax rate or tax laws (see also paragraph 17.6);
- a reassessment of the realisability of deferred tax assets; or
- a change in the expected manner of realisation of an asset.

The resulting change in deferred tax is recognised in the profit and loss account, unless it relates to an item that has historically been recognised directly in equity (DAS 272.504).

Example: Changing tax rates or rules

A company has recognised a deferred tax liability of 200 on the balance sheet. This deferral has been measured at the nominal corporate income tax rate of 25%. Of this deferral, 80 (= 40% of 200) relates to lower measurement of securities for tax purposes and 120 (= 60% of 200) relates to revaluation of property to current value. The company has recognised a revaluation reserve. Suppose the corporate income tax rate changes to 20%. The deferral is then reduced by 40 to 160 (= 200 / 25 x 20). Of that reduction, 16 (= 40% of 40) relates to the lower measurement of the securities for tax purposes and 24 (= 60% of 40) relates to the revaluation. The release of the deferral of 40 is recognised as follows:

- 16 is credited to taxes in the profit and loss account; and
- 24 is added to the revaluation reserve.

Compound financial instruments
Under DAS 290 Financial Instruments, the issuer of a compound instrument (e.g. a convertible bond) recognises the liability component and the equity component separately as a liability and equity respectively (see paragraph 21.8.3). In some countries, the tax base of the liability component at inception is equal to the sum of the two components. In fact, a separate equity component is then not recognised for tax purposes. The resulting taxable temporary difference results from the separate recognition of the liability component and the equity component. In this case, the entity recognises a deferred tax liability. Here, this liability is charged directly to the carrying amount of the equity component (DAS 272.506). Changes in the deferred tax liability related to the liability component are recognised in the profit and loss account as deferred tax expense (or income) (DAS 272.305).

This de facto means that the initial recognition of the deferred tax is charged to equity, and that subsequent expiry of the deferral takes place through the profit and loss account. This is because the tax-deductible interest rate will be lower than the effective interest expense on the loan to be recognised. In this way, the effective tax rate in profit and loss will continue to follow (ceteris paribus) the nominal tax rate.

Example: Deferred tax on compound financial instrument

Company A issues 2,000 convertible bonds on 1 January year 1. These bonds have a maturity of three years and a face value of 1,000 each. The issue proceeds are 2,000,000 (2,000 x 1,000), when we abstract from costs of issuing. Interest at 6% per annum is charged annually in arrears. The holder of the bonds has the right to exchange the bonds for 250 ordinary shares. At the time of the bond issue, the market interest rate for a comparable loan without conversion option is 9%.

In the financial statements, the liability component and the equity component are recognised separately and the next entry (before tax) is made on 1 January (see also the example in paragraph 21.8.3):

Cash	2,000,000	
Bond loan		1,848,122
Other reserves		151,878

The loan is initially measured at fair value (interest and redemption cash flows are discounted at 9%) and subsequently measured at amortised cost. This means that the difference between the redemption value and the carrying amount of the loan is amortised over the term of the loan, resulting in an effective interest rate of 9%. The following entry is made (pre-tax) of the interest expense and payment of coupon interest for year 1:

Interest expense (9% of 1,848,122)	166,331	
Cash (6% of 2,000,000)		120,000
Bond loan		46,331

For tax purposes, the loan is measured at the face value of 2,000,000 and only the nominal coupon rate of 6% is deductible. Therefore, when the bonds are issued, there is a measurement difference in the bond loan of 151,878. This is a temporary difference that is reversed through amortisation of the bond loan. This is a taxable difference because part of the future interest expense is not deductible and therefore more tax has to be paid in the future than would be due on the economic profit or loss. A deferred tax liability should therefore be recognised for this. In the financial statements, the temporary difference of 151,878 has been recognised in equity (Other reserves). This means that the deferred tax liability is also charged to equity. The tax rate is 25%. A additionally makes the following entry on 1 January of year 1:

Other reserves	37,970	
Deferred tax liability (25% of 151,878)		37,970

Tax on the interest expense of year 1 is recognised as follows:

Taxes payable (receivable) (25% of 120,000)	30,000	
Deferred tax liability (25% of 46,331)	11,583	
Tax expense (income) (25% of 166,331)		41,583

17.8 Presentation

In principle, the following are disclosed separately on the balance sheet or in the notes (DAS 272.601):

- tax assets and liabilities;
- deferred tax assets;
- taxes recoverable for the reporting period or a previous reporting period;
- deferred tax liabilities;
- taxes due for the reporting period or a previous reporting period.

For non-deferred tax debt, the law requires separate presentation under the sub-heading taxes and social security contributions (Article 2:375(1)(h) NCC).

For deferred tax liabilities, the law requires separate presentation as a provision for tax liabilities, including the provision for taxes that may arise from measurement above the purchase or construction cost (Article 2:374(4)(a) NCC). As far as possible, the notes will indicate the extent to which they are considered non-current. If income tax is aggregated with other taxes on the balance sheet, a specification should be included in the notes (DAS 272.603).

Deferred tax assets are recognised on a separate line under financial fixed assets and/or on a separate line under current assets (receivables). The distinction between fixed and current assets depends on whether or not the asset in question is intended to serve operations on a continuing basis. Maturity can be helpful in this respect (see paragraph 2.11). The choice may also be to base the distinction on maturities, i.e. to present deferred tax assets that are expected to be recoverable within one year from the reporting date under current assets (receivables) (DAS 272.602). We note that it is not permissible to present deferred tax assets entirely under current assets and explain in the notes what portion is thought to be recoverable after one year. Such a method of presentation does not give a good view of the current portion of the balance sheet and the liquidity position of the entity. The criteria for presenting assets as current are stated in DAS 190.206 (see paragraph 2.11).

Netted presentation on the balance sheet
Current tax receivables and payables for which (1) the entity has a legally enforceable right to settle the receivable and payable on a netted and simultaneous basis and for which (2) the entity has the firm intention to settle them on a simultaneous basis, must be presented on a netted basis (DAS 115.305). In general, in consolidated financial

statements, this refers to the tax receivables and payables of the same fiscal entity (read also fiscal unity; after all, it is considered one entity by the tax authorities) for the same financial year (DAS 272.606).

Deferred tax assets and liabilities are presented netted if and to the extent that (DAS 272.607):

- the entity has a legally enforceable right to set off tax (currently) receivable for a reporting period against tax (currently) due for that reporting period. This is the case, for example, in a fiscal unity in which the tax receivable from one entity for a particular year is offset against the tax payable by another entity for the same year; and
- the deferrals relate to income tax levied by the same tax authority on the same taxable entity or fiscal unity.

This means that differences in maturities do not play a role in the netting of *deferred* tax assets and liabilities. The issue is whether, when the receivables and liabilities become current, there is a proper netting right with the relevant tax authority.

17.9 Disclosure

General
In the notes, the law requires an explanation of whether, and in what way, the impact of taxes on equity and profit or loss is taken into account in connection with a revaluation (Article 2:390(5) NCC). Finally, the law requires separate disclosure of taxes on income from ordinary operations (Article 2:377(1) NCC).

In addition, the Dutch Accounting Standards contain the following disclosure requirements.

Basis for deferred taxes
The method used to measure deferred taxes must be explained (DAS 272.701).

Components of tax expense or income and disclosure of effective tax rate
The principal components of the tax expense or income are disclosed separately (DAS 272.702). The effective and applicable tax rate must be disclosed (DAS 272.703). Where there is a significant deviation between the effective and the applicable (= expected) tax rate compared to the previous reporting period, this is explained (DAS 272.706). The total amount of taxes recognised directly in equity is also disclosed, if applicable (DAS 272.701).

Reconciliation between effective tax rate and nominal rate
The relationship between the profit or loss and the tax amount must be disclosed. This can be done through a numerical reconciliation between (DAS 272.704):

- the tax amount and profit or loss before tax times the applicable tax rate; or
- the average effective tax rate and the applicable tax rate.

In both cases, it is also indicated how that applicable tax rate was calculated (DAS 272.704).

In disclosing the relationship between tax expense or income and profit, an entity will use an applicable tax rate that is the most informative for users of the financial statements. This is often the tax rate in the entity's country of establishment. However, for an entity operating in multiple countries, it may be more informative to assume a sum of country-by-country analyses, or a weighted average of applicable tax rates (DAS 272.705).

Disclosure of not recognised deferred tax assets
The amounts of losses eligible for carry-forward as well as the amounts of the temporary differences are disclosed to the extent that they are not included in the measurement of deferred taxes. The expiry dates of the amounts of not recognised loss carry-forwards are also disclosed. (DAS 272.710). To the extent that there are temporary differences concerning investments in group entities, foreign non-autonomous units, associates and joint ventures for which no deferred taxes have been recognised, the total amount thereof must be disclosed (see paragraph 17.4) (DAS 272.709).

Disclosure of method of presentation and maturity of deferred tax assets
A choice may be made to base the presentation of deferred tax assets under non-current or current assets on (1) whether or not the asset in question is intended to serve operations on a continuing basis or (2) on a maturity basis (see paragraph 17.8). The chosen method of presentation must be explained (DAS 272.602).

The notes will disclose the amount of deferred tax assets presented under financial fixed assets that are expected to be recoverable within one year (DAS 272.602).

Discontinuance of operations
Where there is a distinction between activities that are to be continued and activities that are will be discontinued, the tax expense for the discontinued activities is disclosed as it relates to (DAS 272.713):

- the gain or loss on disposal; and
- the profit or loss for the reporting period of those activities with the corresponding comparative figures.

Measurement at present value
When deferred taxes are measured at present value, the rate applied in discounting (net interest) should be disclosed. In addition, the average maturity should be indicated. Also, the face value of deferred taxes that arose in the reporting period and the face value of the remaining deferred taxes present on the reporting date must be disclosed (DAS 272.707).

Dividend
Where dividends for which no liability has yet been recognised on the balance sheet (see Chapter 14) have consequences on the tax payable by the entity in the following financial year, these consequences are disclosed quantitatively (DAS 272.714).

Different rates for retained profits and distributed profits
In the event of rate differences or other differences for the entity in retaining profits and reserves compared to distributing them, the nature and extent of the potential tax expense or income resulting from any distribution is adequately disclosed. If the determination of nature and/or size is not practicable, this must also be adequately disclosed (DAS 272.715). Such differences do not occur in Dutch tax law.

Uncertain tax positions
Uncertain tax positions are disclosed in accordance with DAS 252 'Provisions, contingent liabilities and contingent assets'. This also applies if uncertain tax positions are not recognised on the balance sheet (DAS 272.716).

Rate changes after reporting date
The entity discloses the substantive consequences on deferred taxes of significant changes in tax rate and legislation announced or enacted after reporting date (DAS 272.716).

Recommended disclosures
It is recommended that a breakdown be provided across the various components (temporary differences, tax credits, available loss carry-forwards) of:

- the amount of deferred tax assets and liabilities recognised on the balance sheet; and
- the amount of the deferred tax expense or income recognised in the profit and loss account, to the extent not already apparent from the changes in the balance sheet item (DAS 272.711).

It is further recommended that disclosure be provided of the recognised deferred tax asset. The reason justifying its recognition is disclosed if (DAS 272.712):

- the realisation of the deferred tax asset depends on future taxable profit in excess of taxable profit arising from the reversal of taxable temporary differences; and
- the entity incurred a loss in the last or penultimate financial year in the country to which the deferred tax asset relates.

Pillar 2 – income taxes
Dutch entities falling within the scope of the Pillar 2 legislation should disclose the following information in the financial statements per financial year (if equal to calendar year).

For an ultimate parent entity of a group or an entity designated as responsible for Pillar 2 income taxes within the group:

- Financial year 2023:
    - a disclosure that the mandatory exception regarding the recognition of deferred tax assets and liabilities related to Pillar 2 income taxes has been applied (dDAS 272.717a); and
    - a disclosure of the expected impact of Pillar 2 legislation. Depending on the specific situation, insight is provided into the status of the implementation and, as far as possible, into the quantitative and/or qualitative impact (dDAS 272.718).
- Financial year 2024:
    - a disclosure that the mandatory exception regarding the recognition of deferred tax assets and liabilities related to Pillar 2 income taxes has been applied (dDAS 272.717a);
    - a disclosure of Pillar 2 income tax expense (or income) recognised in the tax expense (or income) (dDAS 272.717b); and
    - the method of any recharging (dDAS 272.717c).

For other entities:

- Financial year 2023:
    - a disclosure that the mandatory exception regarding the recognition of deferred tax assets and liabilities related to Pillar 2 income taxes has been applied (dDAS 272.717a); and
    - a disclosure of the expected impact of Pillar 2 legislation. Depending on the specific situation, insight is provided into the status of the implementation and, as far as possible, into the quantitative and/or qualitative impact (dDAS 272.718).
- Financial year 2024:
    - a disclosure that the mandatory exception regarding the recognition of deferred tax assets and liabilities related to Pillar 2 income taxes has been applied (dDAS 272.717a);
    - a disclosure of a received Pillar 2 recharge recognised in the tax expense (or income) (dDAS 272.717b). Or a disclosure that there is no recharged Pillar 2 income tax; and
    - the method of any recharging (dDAS272.717c).

The distinction between the disclosure requirements for financial year 2023 and 2024 is because in the Netherlands the Pillar 2 legislation was substantively enacted in financial year 2023 (on 19 December 2023) and it is in force for financial years starting on or after 31 December 2023, thus (in most situations) from financial year 2024. If the financial year is not equal to the calendar year, the disclosure requirements for financial year 2023 mentioned above, apply for broken financial years in which the date of 19 December 2023 falls. The disclosure requirements mentioned above for 2024 will then apply to financial years in which the Pillar 2 legislation is in force, i.e. broken financial years starting on or after 31 December 2023.

17.10 Taxes within a fiscal unity

Introduction

Within a fiscal unity, tax losses of one entity can be offset against the tax profits of another entity. Therefore, the existence of the fiscal unity affects the company-only financial statements of the parent entity (head of the fiscal unity). This also applies to the financial statements of the other companies that are part of the fiscal unity. DAS 272.8 specifically addresses the recognition of taxes in the company-only financial statements of group entities that together form a fiscal unity.

Broadly speaking, in practice, the offsetting of taxes between the parent entity and the subsidiaries that are part of the fiscal unity takes place as follows (DAS 272.803):

- set-off method a: the parent entity settles with the subsidiary as if it were independently taxable;
- set-off method b: the parent entity settles on the basis of the taxable profit or loss of the subsidiary, taking into account the allocation of the benefits of the fiscal unity to the various entities that are part of it;
- set-off method c: the parent entity settles based on the subsidiary's accounting profit or loss; or
- set-off method d: the parent entity bears the entire tax expense.

It is recommended that the method of set-off be laid down contractually (DAS 272.803). Indeed, the agreed set-off method results in legally enforceable receivables and payables between parent and subsidiary. As the set-off method is a contract between parent and subsidiary, other set-off methods than those mentioned above are also possible.

Re a. The parent entity settles with the subsidiary as if it were independently taxable
With this set-off method, in our opinion, proper allocation of taxes within the fiscal unity takes place. Subsidiaries are not granted or denied benefits that they would not have enjoyed or would have enjoyed as independent taxpayers. In this sense, business is conducted between the different entities. This respects the principle that only the parent entity can initiate the fiscal unity through its shareholding. As a result, only those benefits of the fiscal unity are attributed to the parent entities that the subsidiaries, if independently taxable, would not acquire independently.

Re b. The parent entity settles on the basis of the taxable profit or loss of the subsidiary, taking into account the allocation of the benefits of the fiscal unity to the various entities that are part of it
Under this method, loss-making subsidiaries get the benefit of offsetting their losses with profits from other companies. Set-off method b could fit the situation where the parent affects the subsidiary's profit or loss through intercompany pricing and on-charging. After all, under this method, loss-making subsidiaries will be able to realise their loss carry-over rights immediately by recognising an intercompany receivable against the parent. Without the fiscal unity, this loss carry-over could not be realised, except possibly with future tax profits. If the subsidiary goes bankrupt, the receivable (claim for loss relief) against the parent will in principle be claimed by the receiver.

Re c. Parent entity settles based on subsidiary's accounting profit or loss
A disadvantage of this method is that the deferred taxes are not reflected at the entities where the measurement differences exist. An advantage is that the effective tax rate will be equal to the nominal tax rate and that method in itself is straightforward from an administrative point of view. In addition, as with b, loss-making situations lead to (exigible) rights to a receivable from the parent.

Re d. The parent entity bears the entire tax expense
If this method is used, no tax appears at all in the subsidiary's company-only financial statements. As a result, it can be argued that these financial statements do not give a proper insight into the profit or loss achieved by that subsidiary. This is especially the case if the amount distributed as a dividend is not the entire profit. In that case, no proper insight is given into the 'real' equity of the subsidiary. Furthermore, the question is whether there is an arm's length basis for such a set-off arrangement between parent and subsidiary. If there isn't, then the agreement could potentially be legally voidable, for example in case of bankruptcy. The main issue here is the benefit obtained by other entities within the fiscal unity from loss carry-over rights originated at the bankrupt subsidiary.

The differences between set-off methods a, b, c and d are schematically illustrated by the following example.

Example: Tax set-off within fiscal unity

The differences between the profit and loss according to the financial statements and the taxable profit or loss consist of temporary differences. Subsidiary B has no carry-back availability of its own, but does have an unlimited right to carry forward losses. As a result, if subsidiary B were independently taxable for the incurred loss, it would recognise a deferred tax asset. The tax rate is 25%.

	Parent	Subsidiary A	Subsidiary B	Consolidated
Profit or loss according to financial statements	100	500	(300)	300
Taxable profit or loss	80	400	(260)	220
Tax payable to tax authorities	55			55
Year-end value differences (measurement for financial statements minus measurement for tax purposes)	20	100	(40)	80
Set-off method a	**Parent**	**Subsidiary A**	**Subsidiary B**	**Consolidated**
Tax payable to tax authorities	55			55
Parent recharge via current account	(100)	100	-	-
Movement in deferred tax due to temporary differences	5	25	(10)	20
Movement in deferred tax asset related to loss carry-over	-	-	(65)	(65)
Movement in deferred liability for subsidiary loss	65	-	-	65
Tax expense	25	125	(75)	75

Set-off method b	Parent	Subsidiary A	Subsidiary B	Consolidated
Tax payable to tax authorities	55			55
Parent recharge via current account	(35)	100	(65)	
Movement in deferred tax due to temporary differences	5	25	(10)	20
Tax expense	25	125	(75)	75

Set-off method c	Parent	Subsidiary A	Subsidiary B	Consolidated
Tax payable to tax authorities	55			55
Parent recharge via current account	(50)	125	(75)	
Movement in deferred tax due to temporary differences	20	-	-	20
Tax expense	25	125	(75)	75

Set-off method d	Parent	Subsidiary A	Subsidiary B	Consolidated
Tax payable to tax authorities	55			55
Parent recharge via current account	-	-	-	-
Movement in deferred tax due to temporary differences	20	-	-	20
Tax expense	75	-	-	75

The difference between a and b is that under set-off method b, subsidiary B obtains a receivable from the parent (and the parent a liability to subsidiary B) for the amount of the resulting loss carry-over right (65). Under set-off method a, the parent only includes a provision for deferred taxes against subsidiary B and subsidiary B a deferred tax asset against the parent. Subsidiary B only obtains an enforceable claim against, or receivable from, the parent entity for an equal amount of 65 if this receivable would also be realised by the subsidiary when treated as autonomous. Especially in the event of possible bankruptcy of subsidiary B, this makes a significant difference. After all, under set-off method a, subsidiary B does not yet have a receivable from the parent that has fallen due.

Notes

The notes to the financial statements of entities concerned disclose which set-off method is applied within the fiscal unity.

Subsidiaries will recognise deferred taxes on their balance sheets when recognition methods a and b are applied. In the above example, this is evidenced by an equal movement in deferred taxes for subsidiaries A (25) and B (-10) when recognition methods a and b respectively are applied. These deferred taxes are in principle deferred receivables from or liabilities to the parent. The description on the balance sheet or notes should show this for the subsidiary (DAS 272.804). This is without prejudice to the fact that the method of recognition of loss carry-over rights (as also mentioned in the box below the example) differs between method a and b. Whereas method a creates a deferred asset for subsidiary B, method b creates a right to a receivable.

In the application of recognition method c, a tax item is recognised in the subsidiary's profit and loss account but no deferred tax positions are recognised on its balance sheet. It should be explained in the notes that this is related to the chosen method of set-off (DAS 272.804).

If set-off method d is applied, the subsidiary's financial statements should make clear the circumstances on the basis of which no taxes have been recognised in those financial statements, even though the subsidiary is not itself exempt from taxation (DAS 272.804). In the case of the parent entity, the profit and loss account should then allocate the tax expense to its own operations and those of its subsidiaries (DAS 272.805).

If the parent entity's balance sheet has capitalised deferred tax assets because deferred tax liabilities are included in the measurement of subsidiaries, this should be disclosed in the notes (DAS 272.807).

Joint and several liability

For all entities that are part of the fiscal unity, there is legal joint and several liability for tax debt from the period they are part of that fiscal unity. The existence of this joint and several liability must be disclosed under DAS 252 (DAS 272.808).

17.11 Exemptions for medium-sized and small entities

Medium-sized entities are not required to include the following information in the notes:

- temporary differences for which no deferrals have been recognised (DAS 272.709);
- separate disclosure of the tax expense from discontinued operations (DAS 272.713);
- The effect on the tax owed on proposed or declared dividends (DAS 272.714);
- disclosure of the interest rate and average maturity of deferred taxes measured at present value (DAS 272.707);
- rate differences in situations where profits are retained versus situations where they are distributed (DAS 272.715).

Small entities are exempt under Article 2:396 NCC from:

- separate disclosure of deferred tax liabilities and deferred tax assets (Article 2:374(4) NCC);
- separate disclosure of receivables and payables in respect of taxes (Article 2:375(1)(h) NCC).

Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the statutory minimum') in the notes.

17.12 Significant differences from IFRS

Application of the 'initial recognition exemption'
Under IAS 12 'Income taxes', deferred taxes are not recognised for temporary differences if in a transaction, other than a business combination, at the time of initial recognition of that transaction, neither the accounting profit or loss nor the taxable profit or loss is affected. This is called the 'initial recognition exemption'. Under IFRS, the application of the initial recognition exemption is mandatory. Under DAS 272 'Income taxes', this initial recognition exemption is not explicitly addressed, but in our opinion it essentially aligns with the description of 'other temporary differences' (DAS 272.104). Of course, this does not mean that the initial recognition exemption must be applied mandatory under NL GAAP, as is the case under IAS 12.

Recognition of deferred tax in the context of revaluation
IAS 12 prescribes the recognition of deferred tax in the context of revaluation. Under NL GAAP, this requirement does not exist. Article 2:390(5) NCC requires that the notes explain whether and how, in the context of revaluation, the impact of taxes on equity and profit or loss is taken into account. It can be inferred that the law does not require the recognition of a deferral. However, the Dutch Accounting Standards Board expresses a strong preference for recognising a deferral in relation to a revaluation (DAS 272.304).

Deferred tax asset compared to deferred tax liability on revaluation
In the context of recognising a deferred tax asset, it is necessary to assess whether there are sufficient taxable temporary differences. DAS 272 states that taxable temporary differences arising from revaluation should be disregarded in that assessment. IAS 12 does not have this restriction.

Face or present value
IAS 12 requires deferred taxes to be measured at face value at all times. According to DAS 272, deferred taxes may also be measured at present value, although disclosure of the face value of deferred taxes is required in the notes.

Presentation of deferred taxes
IAS 12 indicates that deferred tax assets should be presented as non-current assets. DAS 272 states that deferred tax assets should be recognised on a separate line under financial non-current assets or current receivables (DAS 272.602). For the distinction between non-current and current assets, the provisions of DAS 190.2 apply (see paragraph 2.11). The notes should disclose the amount thought to be recoverable within one year.

18 Employee benefits

18.1 Introduction and scope

Employee benefits include all forms of benefits paid to employees, both during and after their employment (DAS 271.102), irrespective of whether:

- they are employed on the basis of individual employment contracts, collective agreements, legal regulations or agreements, or on the basis of the employer's established practices resulting in obligations towards employees;
- the employer pays either the employees themselves or other parties such as an insurance company or a pension fund; and
- such employment is full or part-time.

The question is whether self-employed and agency workers without regular terms of employment could also fall within the scope of DAS 271, in other words whether self-employed and agency workers may be considered as 'workers with an employment contract'. In our opinion, DAS 271 refers to 'employees'. According to the Dutch Accounting Standards Board, the use of the term 'employee' indicates the existence of an employment contract within the meaning of the Netherlands Civil Code (NCC) (DAS 315.103). Generally, self-employed and agency workers will not have concluded an employment contract and the costs incurred for them are 'costs of subcontracted work and other external costs' or 'other operating expenses' (Decree on annual accounts format, model E). Nevertheless, in certain cases, the provisions of DAS 271 may well be relevant to the recognition of special elements of benefits paid to workers without an employment contract.

Example: Bonus scheme for hired self-employed workers

Before the reporting date for year 1, it is clear that an internal project at company A will start in the spring of year 2 for which three interim self-employed staff will need to be kept on until at least the end of the project. To increase the likelihood of these workers staying on until at least that point, a stay-on bonus is agreed before the reporting date for year 1. According to this contract, the workers have an unconditional right to this bonus once the project has been completed. How should this bonus arrangement be recognised?

Given that it is explicitly linked to the continued rendering of services during the project, the provisions on bonus payments during employment are the most applicable and relevant. Declaring DAS 271 applicable also means that such workers will be treated equally with employees (i.e. workers with an employment contract) subject to similar bonus schemes. As discussed in the next paragraph, such bonus schemes provide contingent rights that, in principle, are recognised as expenses in the period in which the services are rendered. Given these contingent rights, a liability is recognised over the period of the project. The probability of the conditions not being met is taken into account when measuring the liability.

Use of the term 'employee' in this chapter includes an entity's management board members. Benefits paid to management board members and supervisory board members are discussed in paragraph 18.8.

The different types of benefit are:

- benefits during employment (paragraph 18.2);
- termination benefits (paragraph 18.3);
- pension and similar commitments (paragraphs 18.4 to 18.6); and
- early retirement ('VUT') and other non-activity arrangements (paragraph 18.7).

As regards the recognition of share option schemes, see Chapter 28 which deals with share-based payments.

18.2 Employee benefits during employment

Definition

Employee benefits during employment are short-term benefits such as wages and salaries, social security contributions, continued payment during holidays, illness and incapacity for work, contributions to life-course savings schemes, profit-sharing and bonus payments as well as benefits in kind such as provisioning of housing. The term also covers benefits linked to the existence of long-term employment, such as 'jubilee' benefits and additional paid leave (i.e. sabbatical leave).

Recognition in general
In principle, employee benefits are recognised as an expense in the profit and loss account in the period in which the services for which those benefits are paid are rendered. This expense, recognised in the financial statements, is equal to the agreed employee benefits. Employee benefits entail legally enforceable obligations. However, an employer also has an obligation (DAS 271.102) if there is a payment that it cannot realistically avoid, which is referred to as a constructive obligation. If this obligation accrues over time, the cost is recognised as an expense over time (as in the case of holiday and overtime schemes). If not, the cost is recognised when the event giving rise to the obligation occurs (DAS 271.203). Therefore, the recognition of benefits distinguishes between benefits with and benefits without the accrual of rights.

If amounts already paid exceed the benefits owed, the excess should be recognised as a prepayment and accrued income item but only to the extent that it is to be repaid by the employee or settled against future salary payments (DAS 271.202).

Recognition where no rights are accrued
Where an entity pays benefits without any rights being accrued, it recognises the expenses incurred (or expected) in the period in which those benefits are due (DAS 271.204). Continued payment in case of sickness and incapacity for work is an example of benefits without accrual of rights.

Recognition where rights are accrued
Where an entity pays benefits that do involve the accrual of rights, it recognises the expected expenses in that regard during the employee's employment (DAS 271.203). It then recognises a liability at the reporting date. This liability is recognised on the balance sheet under either debts or provisions, depending on the nature of the liability.

The accrual of rights means rights to paid leave accrued during the employee's employment, such as holiday or sabbatical leave, which can be taken or cashed in by the employee in future reporting periods. It also includes the accrual of rights to profit-sharing and bonuses.

Contingent rights (e.g. rights that can only be recognised in the event of continued employment such as 'jubilee' benefits) also give rise to a liability. Determining the amount of this liability takes into account the likelihood of discontinued employment.

Example: Recognition of overtime

Company A is bound by a collective agreement according to which, for certain job groups within the workforce, overtime worked during a calendar year must be taken before 1 May of the following financial year. Instead, an employee subject to this rule may choose to receive payment before that date. The condition for this is that they are still employed by the company on 1 May. This is a benefit with the accrual of rights. At the reporting date (31 December), the company makes a best estimate of the payout it expects to make under this scheme (in cash or in leave hours) based on past experience. The liability thus determined is recognised as a provision (DAS 271.105). In the notes the company discloses that the provision is a current provision (Article 2:374(3) NCC).

Example: Full pay until retirement but with reduced hours

B, a private limited liability entity, has a collective agreement under which employees whose retirement is due to begin within 48 months or less (the 'effective date') and who will then have been employed for at least five years are only required to work 75% of the standard hours under the employment contract without any reduction in salary and fringe benefits. This does not apply to employees who join the company during that five-year period, as they will not have been employed for at least five years by the effective date of this scheme. If an employee participating in the scheme decides to leave the company before their retirement date, they will no longer be entitled to any benefits in this regard. The rights granted are therefore contingent rights (i.e. contingent on continued employment).

The employee accrues the contingent right over the five-year period prior to the effective date. B recognises a liability (provision) for the expenses expected to be accrued during these five years for the employees expected to participate in the scheme. This in effect allocates the expenses to services rendered during the five years preceding the effective date of the scheme, i.e. the period over which rights are accrued and for which the benefit is due.

If the scheme is open to every employee, i.e. no minimum years of service prior to the effective date, it is then a scheme without the accrual of rights. One example of this is a collective agreement that allows older employees in more demanding jobs to take more holidays.

Measurement of liabilities in the event that rights are accrued
The liability for benefits involving the accrual of rights represents a best estimate of the amounts needed to settle the obligations in question at the reporting date (DAS 271.206). A best estimate is generally based on contractual arrangements made with staff, such as collective agreements and individual employment contracts. See Chapter 16 on provisions as regards measurement based on the 'best estimate' principle.

If very few or no uncertainties regarding the settlement of a liability can be identified, any estimate made is normally of limited significance for the overall measurement. Examples include benefits that are unconditional and/or payable in the short term, such as holiday entitlements or the legal right to holiday pay.

If such uncertainties can be identified, however, then any estimate about the settlement of the liability has greater significance for the overall measurement. Examples include benefits that are contingent in nature and/or not payable in the short term, such as 'jubilee' benefits. Elements included in the best estimate of the accrual of, for example, a liability for 'jubilee' benefits are:

- employees to whom the arrangement applies;
- the benefit percentage of their salaries;
- the salaries themselves;
- any expected salary increases;
- years accrued;
- likelihood of remaining in employment (including or excluding the likelihood of death); and
- the discount rate used to calculate the present value.

If the effect of the time value of money is material, the liability should be measured at the present value of the necessary expenditures expected for its settlement (DAS 271.207). The pre-tax discount rate used for discounting cash flows reflects current market interest rates. This does not include risks already taken into account when estimating future expenditures. The market interest rate for high-yield corporate bonds at the reporting date is normally most appropriate for determining the current market interest rate. Additions to and releases of liabilities should be charged and credited to the profit and loss account, respectively (DAS 271.208).

Incapacity for work
A provision is recognised for obligations existing at the reporting date for the continued future payment of benefits to employees who, on the reporting date, are expected to be permanently wholly or partly unable to perform work due to illness or incapacity for work (DAS 271.205). The entity has this obligation if the following conditions are cumulatively met at the reporting date:

- the employee is wholly or partially unable to perform work due to illness or incapacity for work;
- their illness or incapacity for work is not expected to end during the remaining period of employment; and
- the entity has the obligation to make continued future payment of benefits to the employee and is directly responsible for their payment.

This means that no provision is recognised for existing cases of sickness if the employee in question are expected to fully recover during the remainder of their employment. An assessment of whether the employee's illness or incapacity for work will (or will not) end during the remaining period of employment includes consideration of elements such as the likelihood of rehabilitation et cetera.

Liabilities for the continued future payment of benefits include termination benefits (DAS 271.205). This means that, for example, any transition payments owed to such employees under the Balanced Labour Market Act (*Wet arbeidsmarkt in balans*) must be included in the provision if they qualify as termination benefits.

Profit-sharing and bonus payments
An entity recognises the expected cost of profit-sharing and bonus payments only when (DAS 271.209):

- the liability to make such payments arose on or before the reporting date; and
- a reliable estimate of the liability can be made.

If such profit-sharing and/or bonus payments are contingent on continued employment, it is a contingent right that gives rise to an liability during employment. Determining the amount of this liability takes into account the likelihood of discontinued employment.

Example: Profit-sharing scheme

Entity A wants to distribute a fixed percentage of profits for the whole of year 1 to all employees employed in January of year 1. However, the condition is that they must still be employed by A in the month in which the benefit is paid (May of year 2). If all employees are still employed by then, this percentage is 3%. At reporting date (end of year 1), the company estimates that 90% of employees employed in January of year 1 will still be employed by it in May of year 2.

At reporting date, A recognises a liability of 2.7% (90%x3%) of the profit for year 1 and includes it under employee costs. The liability thus determined is recognised as a provision (DAS 271.105). This is classified as a current provision in the notes (Article 2:374(3) NCC).

Insurance of risks due to incapacity for work
To the extent that the entity's risk due to incapacity for work is insured - either through the public system or through an insurer - a provision may be made for the portion of insurance premiums payable in the future that is directly attributable to the entity's individual claims history (DAS 271.210). This could include differentiated insurance premiums. As an alternative recognition method, differentiated premiums may be recognised solely in the period(s) for which they are due (DAS 271.210). If the entity opts for this alternative recognition method and circumstances existing on the reporting date - such as differentiated insurance premiums already set for future years - are expected to have a material impact on the level of future employee expenses, this should in any case be disclosed (DAS 271.213). If no reliable estimate can be made of the portion of insurance premiums payable in the future that is directly attributable to the entity's individual claims history, no provision should be recognised (DAS 271.210).

Presentation and disclosure
Liabilities for benefits during employment are presented as either a provision or a debt, in accordance with their nature. A liability is classified as a provision if the amount or timing of its settlement is uncertain. In all other cases, a liability is recognised as a debt. The generally required disclosure regarding provisions (see Chapter 16) also applies to provisions made for benefits during employment.

Expenses are recognised in the profit and loss account as part of operating profit. Pursuant to Article 2:377 NCC, the following are listed separately:

- wages;
- social security expenses; and
- pension expenditure (as part of social security expenses).

According to Article 2:382 NCC, the average number of employees must be disclosed. This is the number of employees with whom an employment contract has been entered into under current employment law. In principle, therefore, this does not include hired self-employed and agency workers. The law does not provide any further clarification about whether the number of employees should be expressed as FTEs. In any case, we consider the disclosure of FTE's acceptable. Indeed, this is in line with the DASB recommendation regarding the application of size criteria (DAS 315.103, see paragraph 1.5). A presentation according to how the business is organised is also required by law. This should include the number of employees working outside the Netherlands. The law does not provide any further details in this regard. However, a breakdown in accordance with the reportable segments (DAS 350) seems the most obvious option.

If the entity prepares consolidated financial statements, Article 2:410(5) NCC requires the same information to be disclosed as that referred to in Article 2:382 NCC for the entirety of the companies fully included in the consolidation.

This information must also be disclosed separately for the entirety of the companies (joint ventures) that are proportionally consolidated under Article 2:409 NCC.

According to Article 2:363(3) NCC, the information required under Article 2:382 NCC may not be omitted. This information should be disclosed in both the company-only and the consolidated financial statements. The reason that these disclosure may not be omitted is due to the importance of these disclosures for the assessment of the size regime (Articles 2:395a-397 NCC) or the application (if any) of the structure regime (Articles 2:153(2) and 2:263(2) NCC).

18.3 Termination benefits

Definition
Termination benefits are benefits granted to an employee in exchange for terminating their employment. Termination benefits are usually fixed benefits, but sometimes also include a post-employment benefit enhancement (pension) or continued salary payments until the end of a certain notice period during which the employee performs no further services that generate economic benefits for the entity.

Termination benefits should be distinguished from benefits in exchange for work performance that generates economic benefits for the employer during the remaining period of service. Thus, provided the employee remains in service for a certain period of time, a benefit granted due to termination is not a termination benefit but rather a benefit paid for services rendered during the remainder of the employee's employment.

Example: Benefits paid for remaining service

Company A decides to dismiss an employee due to restructuring. However, it intends to have the employee deal with a number of outstanding issues. A offers the employee a benefit of 12,000, payable upon termination, on condition that the employee remains employed for another six months.

This benefit of 12,000 represents payment for services rendered during the employee's remaining six months of service. A charges this amount to the profit and loss account during that period (2,000 per month).

Examples of termination benefits are benefits that (DAS 271.502a):

- are granted under a settlement agreement to terminate employment and which are also not conditional on continued employment;
- are granted in accordance with the agreed employee benefits as a result of the decision of the entity (employer) to terminate the employment and are not conditional on continued employment either;
- relate to salary until the end of a notice period if the employee renders no further services;
- are due under the Balanced Labour Market Act (transition payments) when employment is terminated indefinitely.

Examples of benefits in exchange for services rendered are allowances (DAS 271.502a):

- granted due to the termination of employment on condition that the employee remains employed for a certain period of time;
- to which the employee is entitled under the prevailing terms of employment in the event of voluntary termination;
- due under the Balanced Labour Market Act (transition payments) when a temporary employment contract is not renewed if it was highly likely that it would not be renewed when it was entered into. Depending on the facts and circumstances, the 'unit of account' may be at the level of the individual contract or at a higher level, such as a group of employees occupying a similar position.

For older employees who only need to work a few more years before reaching the retirement age and therefore the end of their employment, special arrangements are sometimes agreed which often amount to working fewer hours on the same salary. If the continued payment of full salary is contingent on the continuation of employment, then there is no question of any payment of termination benefits. Instead, the salary costs should be regarded as benefits paid in exchange for rendering services (see paragraph 18.2).

Example: Full pay until retirement but with reduced hours

According to a collective agreement, an employee who only has another 48 months or less before reaching the age of retirement is only required to work 75% of the standard hours under their employment contract without any reduction in salary and fringe benefits. If the employee decides to retire from service before reaching the age of retirement, they will no longer be entitled to any benefits in this regard. Thus, the scheme is entirely dependent on the employee's continued employment. It is not a redundancy scheme (not even a 25% redundancy scheme) because it is contingent on the continuation of employment and also, therefore, on the employee continuing to render services that generate economic benefits.

Recognition and measurement
A liability for termination benefits is recognised as a charge to profit or loss when an entity has demonstrably and unconditionally undertaken to pay them. This includes the situation in which the entity has made an irrevocable offer to an employee, irrespective of whether the employee has accepted the offer (DAS 271.503). If the termination is part of restructuring, an entity recognises the cost of a termination benefit in a restructuring provision in accordance with the description given in paragraph 16.7.1. This may result in the recognition of a liability where an unconditional obligation only arises after the reporting date (see paragraph 16.7.1).

Measurement of this liability takes into account the likelihood of the employee not accepting the offer. The fact is that liabilities for termination benefits are measured at the best estimate of the amounts necessary to settle the liabilities (DAS 271.504). If the effect of the time value of money is material, the liability must be recognised at present value. These principles are the same as for the measurement of liabilities where rights are accrued (see also paragraph 18.2).

It could be the case that a termination benefit consists of the enhancement of an employee's pension. In that case, the liability must be measured at the reporting date as described in paragraph 18.5 regarding the measurement of pension liabilities (DAS 271.504).

Presentation
The liability at the reporting date is a provision if there is still a degree of uncertainty about the extent of it. If not, it is recognised under debts (DAS 271.507).

The normal rules apply to classification in the profit and loss account. See Chapter 23 in this regard.

18.4 Pension and similar commitments

18.4.1 Introduction

Paragraph 3 of DAS 271 'Employee benefits' sets out the provisions for the recognition of pensions in the financial statements. Central to these guidelines are the terms 'obligation-to-pension fund approach' and 'obligation-to-employee approach'. DAS 271.3 distinguishes between Dutch and foreign pension arrangements. In addition, Dutch pension arrangements treat pension provisions for director-major shareholders separately.

The distinction made in standards for Dutch and foreign pension arrangements is based on the strict separation between the responsibilities of the entity, the pension fund and participants in the pension arrangements and the sharing of risks between these parties under the Dutch Pensions Act (*Pensioenwet*). This strict separation is specific to the Dutch situation and the Dutch Accounting Standards Board has therefore deliberately chosen an approach in DAS 271.3 that reflects this situation.

The provisions of DAS 271.3 apply not only to formally agreed legally enforceable commitments, but also to obligations based on the entity's established practices. They also apply to entitlements to be granted by virtue of the entity's firm intention to establish pension arrangements. In the latter case, recognition in the financial statements is based on a specified plan (DAS 271.303).

18.4.2 Application of IFRS or US GAAP

According to DAS 271.101, an entity's financial statements may apply the standards applicable under either US GAAP or IFRS for pensions and other post-retirement benefits instead of the standards set out in DAS 271.3. The condition for this is that the standards chosen are applied integrally and consistently. In applying this option, all of the entity's pension arrangements, both Dutch and foreign, are recognised, measured, presented and disclosed consistently and in accordance with one of these standards.

18.4.3 Definitions

Pensions means pension commitments and other benefits, temporary or otherwise, after the end of an employee's active service. Pension commitments comprise the entitlements of employees, former employees or their survivors to periodic benefits dependent on their being alive, commencing at retirement age or the death of the employee, whichever is the earlier, such as entitlements to old-age and survivors' pensions and pre-pensions (DAS 271.301). Other benefits paid after the end of an employee's active service, whether temporary or otherwise, may include contributions to health care costs or health insurance premiums.

Under the Pensions Act, a Dutch entity must place pension commitments made to employees with a pension fund in the form of (DAS 271.302):

- a company pension fund;
- an industry-wide pension fund; or
- a life insurance company.

The employer enters into an agreement with the pension fund regarding the implementation of one or more pension arrangements. Such an agreement is called an administration agreement (DAS 271.0).

18.4.4 Accounting treatment of pension arrangements

Obligation-to-pension fund approach and obligation-to-employee approach
Under DAS 271.3, the 'obligation-to-pension fund approach' applies to Dutch pension arrangements covered by the Pensions Act. This also applies to foreign schemes that are similar to the design and operation of the Dutch pension system. Under this approach, the entity's liability for its pension commitments is based on the funding arrangements set out in the administration agreement between the entity and the pension fund (DAS 271.0).

In addition, the 'obligation-to-employee approach' has to be adhered to for commitments that have not yet been placed with a pension fund. This applies to, for example, pension commitments held by the entity itself as well as to foreign pension arrangements that are not similar to the design and operation of the Dutch pension system. In this approach, the liability for any pension commitment made by the entity is based on the retirement benefits paid to the employee after their active service ends. The amount is determined on the basis of an actuarial measurement method (DAS 271.0).

It could also be the case that an entity has made pension commitments under a Dutch pension arrangements covered by the Pensions Act but has not yet placed them with a pension fund. In that case, it applies both the 'obligation-to-pension fund approach' (for commitments placed with the pension fund) and the 'obligation-to-employee approach' (for commitments not yet placed with the pension fund).

We note that IFRS does not make any distinction between these two approaches (IAS 19). The underlying idea is, in particular, that in the case of a separation between pension fund and the employer as in the Dutch pension system, the cost of a pension commitment for an employer is limited to the payments it is obliged to make to the pension fund under the administration agreement. Given that the pension fund is responsible for administering the pension arrangements and, in that regard, is required to represent the interests of all scheme members in a balanced way, the fund has to be continuously alert as to whether the employer's contribution payments will be sufficient for administering the scheme. It is certainly not a foregone conclusion in the Netherlands that the employer is responsible for any increased contribution required as a result of an increase in the accrual rate (the rate at which pension is increased during an employee's service based on their salary). In most pension arrangements, a mix of measures, including reductions in the accrual rate itself, will restore the balance between funding and the pension commitment. This means that actuarial risks (including investment risks) are shared between the employer and the participants (employees, former employees, pensioners) in the fund. The risks are likewise shared when ratios fall below the requisite minimum levels. Generally, increases in contributions, or additional payments made by the employer (to the extent possible under the administration agreement), only play a limited part in restoring the funding ratio to the extent envisaged.

Thus, under the 'obligation-to-pension fund approach', the funding framework is decisive for the allocation of pension expenses over the period of employment, while under the 'obligation-to-employee approach', the cost of the pension commitment itself is taken as the starting point for accrual during the employee's employment. The latter approach assumes that any commitments made by the employer must ultimately be paid by the employer itself. This is still the approach taken by IFRS/IAS 19. See the next paragraph for the measurement of liabilities under these approaches.

Future Pensions Act
It is important to note here that in June 2020, after almost 10 years of discussion, the government and the social partners (unions representing employers and employees) reached agreement on an updated Netherlands pension system. Known as the pension agreement (*pensioenakkoord*), it has now been fleshed out in the Future Pensions Act (*Wet toekomst pensioenen*, 'Wtp'). This law entered into force on 1 July 2023. There is a transition period, until 1 January 2028 at the latest, to allow the social partners and the pension funds (company pension funds, industry-wide pension funds and life insurance companies) time to adapt pension arrangements to the new legislation. Under the new system, the commitment to employees has been 'softened' compared to the old system. There will no longer be a minimum pension commitment. Instead, there will be range shaped by actuarial trends and investment returns. Given the above, the new regime will confirm the fact that actuarial and investment risks lie with the participants, meaning that actual retirement benefits will depend on the circumstances. The new regime underlines and reinforces the separation of responsibilities underpinning the 'obligation-to-pension fund approach'.

Future Pensions Act and compensation payments
The Wtp provides that groups of employees affected by the transition to the updated pension system, must be adequately and cost-neutrally compensated. This is expected to concern, in particular, the group of employees in the 40-55 age group. If, and to the extent, that the compensation is to be financed by the employer, and the conditions discussed in paragraph 18.5.1 are met, a liability arises to the pension fund that must be recognised within personnel expenses in the profit and loss account. A liability will also have to be recognised for other types of payments to be made by the employer under the transitional arrangements to the new system (for example, an agreement to make a one-time additional payment to a solidarity or risk-sharing reserve). Such obligations should be recognised at the time the conditions for recognising a provision are met (DAS 271.307). Typically, this will be when the agreements made in the transition documents are signed. Obviously, these employer-funded transition obligations should be adequately disclosed.

Foreign pension arrangements
Foreign pension arrangements, must be assessed to ascertain whether they are similar to the design and operation of the Dutch pension system. The following elements are important in this regard (DAS 271.320):

- the pension fund is a standalone, employer-independent fund responsible for paying pensions;
- the funding provided by the associated entity covers costs;
- this cost-covering funding will be determined according to a generally acceptable actuarial measurement method (the Financial Assessment Framework (*Financieel Toetsingskader* 'FTK') applies in this regard);
- an independent regulator (such as the Dutch Central Bank (DNB) or the AFM in the Netherlands) actively supervises the pension funds in question.

18.5 Measurement and determination of profit or loss of pension commitments

18.5.1 Obligation-to-pension fund approach

18.5.1.1 General

In the obligation-to-pension fund approach, liabilities (and receivables) are recognised on the balance sheet for:

- contributions payable to the pension fund; and
- additional obligations to the pension fund, such as for:
    - indexation (i.e. supplements);

- supplementing deficits (in the form of top-up contributions or otherwise);
- excess interest or profit sharing; and
- value transfers when employees enter and leave employment.

Liabilities should also be recognised for commitments to employees that have not yet been placed with a pension fund. These are recognised using the obligation-to-employee approach.

18.5.1.2 Contributions payable to the pension fund

Contributions payable to the pension fund must be recognised as expenses in the profit and loss account. Any contribution owed to the pension fund that has not been paid for any year is recognised as a liability on the balance sheet. This can often be based on the current account between the company and the pension fund.

18.5.1.3 Additional liabilities to the pension fund

General
In addition to the obligation for the contribution owed at the reporting date, the entity must assess whether it has other obligations as well. These would be due to the administration agreement or the insurance contract and/or other agreements with employees as well as the legitimate expectations they have been given.

If the entity has obligations in addition to the contribution payable to the pension fund, a provision must be recognised if the following general conditions for recognising provisions are met at the reporting date (DAS 271.307):

- the entity has a legal or constructive obligation to the pension fund and/or the employee;
- it is likely that settlement of that obligation will require an outflow of funds from the entity; and
- a reliable estimate can be made of the size of the obligation.

The size of this pension provision for additional obligations is measured on the basis of a best estimate of the amounts needed to settle the obligations in question at the reporting date (DAS 271.315). This best estimate is generally based on the pension agreement, the pension scheme rules and the administration agreement. Furthermore, the pension provision should be in compliance with DAS 252 on provisions. See Chapter 16.

The liabilities may be measured at face value unless the effect of the time value of money is material (if the period over which the expenditures are discounted does not exceed one year, DAS 271.316 provides that the effect is not material). They should then be measured at the present value of the expenditures the entity expects it will need to make to settle them. This requires the use of a pre-tax discount rate that reflects the current market interest rate. This should not include risks already taken into account when estimating future expenditures. In this regard, DAS 271.316 expresses a preference for using the market interest rate of high-yield corporate bonds at the reporting date. If one applies an actuarial measurement method, measurement is at present value.

Additions to and releases of liabilities should be charged and credited to the profit and loss account, respectively (DAS 271.317).

Indexation
The entity may have a liability for indexation at the reporting date. A provision is recognised if:

- indexation is payable by the entity; and
- has not yet been funded at the reporting date.

If pensions are indexed, indexation is automatic or an unconditional decision has been taken to index them (DAS 271.307).

The last sentence refers to both conditionally indexed pension arrangements ('unconditional decision') and unconditionally indexed pension arrangements ('automatic indexation'). It should be noted that the latter does not include all future indexation. A provision should only be created for future unconditional indexation of entitlements accrued up to and including the reporting date (to the extent they are not yet funded). No provision is created for future indexation of entitlements to be accrued after the reporting date, even if they are unconditional.

Example: Unconditionally indexed average pay scheme

Let us assume that in an average play scheme, accrued entitlements are automatically tied to the consumer price index (CPI). Thus, entitlements are indexed unconditionally, but the level of indexation is tied to the CPI index. On 28 January of year 2, it is announced that the CPI rose by 2.5% in year 1. In April of year 2, the pension fund fixes participants' entitlements based on this index. This indexation has not yet been funded. The company will receive an invoice for additional contribution at the end of April year 2. The financial statements for year 1 have already been finalised, specifically on 28 March of year 2.

When preparing the financial statements, a provision must be recognised using a best estimate (by the company's management) of the additional contribution the entity expects to owe. In addition, a provision must be recognised for future expected indexation of the entitlements accrued at the reporting date. This requires a best estimate of future movements in the CPI and additional contributions payable as a result. We note here that this form of additional financing is not allowed under the Pensions Act. It could, however, be used in self-administered situations (referred to as open indexation arrangements).

The indexation of conditionally indexed pension arrangements depends on certain conditions or circumstances of the pension fund. There is then no automatic right to an increase in the pension or pension entitlement. Instead, it depends on the specified conditions being met. For example, one condition may be a specific minimum funding ratio at the reporting date. If the specified conditions are met as at the reporting date, there is then an obligation to index at the reporting date. However, it is up to the management board of the pension fund to make this decision. Generally, it will only be at the time of that decision that information is available from the employer making it possible to determine whether there is a liability at the reporting date. In our opinion, if this decision is made after the reporting date, this is an event that provides further information about the factual situation at the reporting date (i.e. the existence of an indexation obligation at the reporting date), which should be recognised in the financial statements (DAS 271.310). This decision made after the reporting date will then still result in recognition of a liability at the reporting date (if and to the extent that the indexation is payable by the entity and has not yet been funded). A liability must also be recognised if no formal decision has yet been taken by the time the financial statements are prepared, but other information is available showing that the entity has a liability at the reporting date and its size can be reliably estimated (DAS 271.307).

There is no obligation to index if the pension fund's buffer capital is used to finance the indexation. The fact is that the employer does not finance it in that case. In this situation, therefore, the fund's own available buffer capital is used. The employer may of course decide to fund part of the indexation itself, in consultation with the management board of the fund. This is often done for active participants (i.e. employees on the payroll) in the context of negotiations on the margin arising out of wage negotiations and its distribution. The obligation-to-the-pension fund then arises when the agreement is ratified and the pension fund is informed. See also the following example.

Example: Conditionally indexed average pay scheme

Let us assume that, according to the pension arrangements, pension entitlements are accrued on an average pay basis. In addition, the accrued entitlements are *conditionally* tied to the CPI. This is conditional on the fund's funding ratio being at least 120 and not falling below this level as a result of indexation. On 28 January of year 2, it is announced that the CPI rose by 2.2% in year 1. On 31 January of year 2, the pension fund decides to increase pension entitlements accrued up to 31 December of year 1 by 1%.

Situation 1: the employer does not receive an invoice for additional contribution because the indexation is funded from the pension fund's available resources. The employer need not make any provision in this case because the indexation does not lead to any outflow of its funds and therefore does not create a liability. This is a clear consequence of the 'obligation-to-pension fund approach'.

Situation 2: same as situation 1. Given favourable earnings trends, the employer is also willing to increase indexation for active employees to 2.2%. The employer will finance this (i.e. the additional 1.2% indexation). This agreement will be confirmed and communicated on 1 March of year 2. In this case, the obligation to the pension fund only arises on 1 March of year 2. Therefore, at the end of year 1, the employer may not yet recognise any liability. If the effect of this arrangement is material, however, it will have to be disclosed.

Supplementing of deficits (in the form of top-up contributions or otherwise)
The Dutch Central Bank (DNB) requires pension funds to maintain specific funding ratios and/or build up certain reserves. The pension fund may pass on the cost of any top-up contributions to make up for the funding or reserve deficit to the employer. The employer does not recognise a provision for these top-up contributions unless they are based on an obligation to make additional payments to the pension fund (DAS 271.311) on the basis of the administration agreement or legitimate expectations. In practice, this means that, in principle, no provision is necessary for top-up contributions included in the regular contribution payments to the pension fund (e.g. in the form of a percentage of pensionable salary). One exception to this is situations where, according to the administration agreement or the commitments made, the pension fund may hold the employer liable for the funding or reserve shortfall. In such situations, it makes a best estimate of the top-up amount owed by the employer, irrespective of whether it pays that amount in one lump sum or instalments. The following examples clarify the above.

If the employer has a legal obligation to make an additional lump-sum payment, it must recognise a liability for it in its balance sheet.

Example: Legal obligation to make additional payment

The administration agreement with the company pension fund stipulates that the employer must make top-up payments to restore the funding ratio to 115 if and to the extent that it has fallen below this level at the reporting date. At 31 December, the funding ratio is 108. At the time of preparing the financial statements, the pension fund's management board has not yet decided on the amount of the top-up.

In this situation, it is clear that the pension fund is legally entitled to hold the employer to this top-up obligation. The employer recognises a provision based on the best estimate of the amount it owes, taking into account all information available up to the time the financial statements are prepared.

In the absence of a legal obligation, there may be a constructive obligation that requires an entity to recognise a liability on the balance sheet.

Example: Constructive obligation to make an additional payment

On 15 December, an employer promises the Works Council that it will pay an additional 10 million into the pension fund, even though it is not obliged to do so under the administration agreement. At the reporting date of 31 December, the employees have a legitimate expectation that the employer will make an additional payment. The employer must recognise a liability of 10 million.

If it has made this commitment after the reporting date and the employees did not have a legitimate expectation at the reporting date that the employer would make an additional payment, that commitment is only recognised in the new financial year. However, a subsequent event with a significant impact could occur, which would need to be disclosed.

If the obligation to make up a deficit is met by paying top-up contributions, it may be more difficult to determine whether a liability should be recognised on the balance sheet. The fact is that a liability only has to be recognised for top-up contributions if it is 'based on the administration agreement or legitimate expectations, or on an obligation for the entity to make additional payments to the pension fund.' (DAS 271.311).

Specifically, this means that, in principle, a provision does not need be recognised for top-up contributions included in regular contribution payments, e.g. if the contributions are a certain percentage of pensionable salary.

Example: Top-up contributions included in regular contribution payments

A pension fund works with a graduated scale according to which the contribution rate increases if the pension fund's funding ratio falls. The maximum contribution is 27.5% of an employee's pensionable salary. This cap applies at a funding ratio below 105. The recovery plan submitted to DNB assumes this percentage for the next five years.

Under DAS 271.311, no provision is recognised, as the top-up contributions are included in regular contribution payments.

However, if the administration agreement or commitments made indicate that the employer can be held accountable for the fund's recovery, the employer recognises a liability. The employer then makes a best estimate of the top-up amount, irrespective of whether it is paid in one lump sum or in instalments.

Example: Top-up contributions not included in regular contribution payments

An employer agrees with the management board of the pension fund that it will make an additional deposit of 10 million. The employer wants to pay this amount in instalments. It is therefore agreed that the employer's share of the regular contribution will increase from 16% to 22% over the next five years. The employee contribution will not be increased, remaining fixed at a maximum of 8%.

In this situation, it is clear that the agreed top-up is factored into the pension contributions owed. The employer recognises a provision for this based on a best estimate of its additional contribution payments due to the 6% increase in its share. The benchmark for this is 10 million. In this simple example, it is easy to distinguish between 'regular' and 'additional' contributions. In other situations, more professional judgment will be required to make this distinction.

Excess interest or profit sharing
For insured schemes, the administration agreement may provide that excess interest or profit sharing will be made available to the entity. This is generally determined and settled after the end of the relevant insurance year (generally the calendar year). In that case, the entity recognises a receivable at the reporting date for the excess interest/profit sharing up to that date.

Value transfers
According to the Pensions Act, when moving to an employer, employees have a legal right to transfer their accrued pension entitlements from the old pension fund to the new employer's pension fund. The transfer value between the old employer's and the new employer's pension fund is determined by law. The legal transfer value and the actual required/accrued value may differ. These differences are often settled between the old and the new employer. Note that both the old and the new employer may be required to settle up. This could be either a positive amount (a receivable) or a negative one (a payable).

If it is already known at the reporting date that former or new employees have exercised or will exercise their right to individual value transfer, the company must estimate the extent to which this value transfer will have financial consequences for the employer. This is about employees who joined or who left employment on or before the reporting date. This does not, therefore, involve for employees who joint or leave employment after the reporting date. At the reporting date, the company must make a best estimate of the expected financial consequences of settling these value transfers. A provision or a receivable must be recognised on the balance sheet for this.

18.5.2 Obligation-to-employee approach

18.5.2.1 General

The obligation-to-employee approach is required for all pension commitments not (or not yet) placed with a pension fund. It also applies to all pension commitments that have indeed been placed with a pension fund but not according to the requirements of the Pension Act. In summary, these may be:

- commitments to employees that have not yet been placed with a pension fund;
- director-major shareholder pension arrangements that are administered by the entity itself; and
- foreign pension arrangements.

The amount of the eventual pension provision is measured based on a best estimate of the amounts necessary to settle the related obligations at the reporting date (DAS 271.315). This best estimate is generally based on the pension agreement, the pension rules and the administration agreement. Furthermore, the pension provision should be in compliance with DAS 252 on provisions. See Chapter 16.

The pension provision may be measured at face value unless the effect of the time value of money is material (if the period over which expenditures are discounted is not more than one year, then the effect is not material according to DAS 271.316). The pension provision should then be measured at the present value of the expected expenditures required to settle the liabilities. This requires the use of a pre-tax discount rate that reflects the current market interest rate. This should not include risks already taken into account when estimating future expenditures. In this regard, DAS 271.316 expresses a preference for using the market interest rate of high-yield corporate bonds at the reporting date.

Additions to and releases of the pension provision should be charged and credited to the profit and loss account respectively (DAS 271.317).

18.5.2.2 Commitments to employees that have not yet been placed with a pension fund

Promised salary increases in final salary plans
A provision must be recognised for adjustments to accrued entitlements at the reporting date due to future salary increases that have already been promised as at the reporting date and are payable by the entity (DAS 271.314).

In the Netherlands, there is a general obligation under the Pensions Act to fund unconditional entitlements by placing them with a pension fund. Any unfunded backservice element (payable by the entity) of a salary increase promised at the reporting date in a final salary plan gives rise to a liability. A promised salary increase may, for example, be based on collective or individual agreements.

Example: Promised salary increase in final salary plan

Let us assume that entitlements in pension arrangements are accrued on a final salary basis with funding based on actuarial contributions. According to a collective agreement, employees are to be granted a 3% annual salary increase for the next three years. Due to the nature of the pension arrangements (final salary plan), the pension fund will charge 'backservice increments' for those years given the promised salary increases.

A provision must be made at the reporting date. The size of it should be based on a best estimate of the expected backservice increments due as a result of promised salary increases.

DAS 271.314 also provides an alternative, which is the option to take into account the 'coming backservice' when measuring the pension liability in a final play plan, i.e. adjustments due to expected future salary increases or indexation of entitlements accrued at the reporting date. In effect, this makes it possible to apply the projected unit credit method (prescribed by IFRS) to these kinds of plans.

18.5.2.3 Self-administered pension arrangements and retirement liabilities as regards director-major shareholders

A provision must be recognised for the pension liability accrued at the reporting date for self-administered pension arrangements for director-major shareholders. This liability consists of the accrued pension entitlements, including unconditionally agreed (future) indexation of the accrued entitlements (DAS 271.318). This also applies to any liability for self-administered pension for director-major shareholders that has already commenced. Pension arrangements are self-administered if they are administered by the entity itself or by a holding entity or body that manages management board members' pensions (DAS 271.318).

The Self-Administered Pensions (Phaseout) and other Tax-Related Pension Measures Act (*Wet uitfasering pensioen in eigen beheer en overige fiscale pensioenmaatregelen*) entered into force on 1 April 2017. Put briefly, under this act, any further tax-facilitated accrual of self-administered pensions is no longer allowed since 30 June 2017. To prevent adverse tax consequences, self-administered pensions had to be made non-contributory by that date and the pension agreement setting out the pension arrangements between the entity and the director-major shareholder had to be amended. It follows from the Explanatory Memorandum to this act that accrued contribution-free entitlements:

- may continue to be self-administered. The relevant entitlements will then only be adjusted in line with indexation (if and to the extent agreed). A pension provision is then recognised in the financial statements; or
- could be reduced in value (written down) without tax consequences to the tax base of the pension liability for corporate income tax purposes in 2017, 2018 or 2019; and
    - are converted into a so-called 'retirement liability'. A retirement liability is then recognised in the financial statements; and/or

- are commuted (subject to income tax). After commutation, no further pension provision or retirement liability is recognised in the financial statements.

Measurement of pension provision
A provision must be recognised for the pension liability accrued at the reporting date for any accrued contribution-free entitlements that are still self-administered. This pension provision is measured on the basis of an actuarial measurement method generally accepted in the Netherlands (DAS 271.318a). This measurement should be made on the best estimate principle, meaning that the actuarial assumptions to be made are based on the best estimate of the variables that will determine the expenditures (DAS 271.318a). As a result, age corrections should be applied for example. Age corrections are adjustments to previous mortality tables used to make best estimates of future mortality rates. Furthermore, the discount rate should be set at the current market interest rate at the reporting date. Use of the market rate of high-yield corporate bonds is most appropriate in this regard (DAS 271.316). This discount rate applies to all provisions measured at present value.

Choices between measurement principles used
Calculating the pension provision for director-major shareholders must at least take into account the pension entitlements accrued at the reporting date, including any unconditionally agreed (future) indexation (DAS 271.318). According to the Dutch Accounting Standards, taking into account conditionally agreed (future) indexation and future salary increases is allowed (DAS 271.318a). This effectively means that the projected unit credit method prescribed by IFRS can be applied.

As regards indexation, it follows that careful consideration must be given to whether it has been agreed unconditionally or conditionally. 'Open indexation' is often agreed for self-administered arrangements. This involves adjusting pension rights or benefits in line with wage or price trends, expressed as a general index. In practice, many pension agreements provide that a pension that has already commenced or a non-contributory pension is indexed annually (or words to the same effect) 'if possible'. In that case, indexation is conditionally agreed, as the actual pension payment depends on future events and circumstances. However, 'open indexation' can also be agreed unconditionally.

Since the introduction of the Self-Administered Pensions (Phaseout) and other Tax-Related Pension Measures Act on 1 April 2017, future salary increases no longer affect the size of the provision. The fact is that self-administered pensions have to have been made non-contributory, meaning that accrued entitlements are only adjusted in line with indexation (if and to the extent agreed).

Insurance rates
When measuring a self-administered pension liability, one possible question is the extent to which that liability should or may be measured at the amount at which it can be transferred to a professional insurer. Insurance rates assume a rate (prescribed by the Dutch Central Bank) lower than the market rate for high-yield corporate bonds. They also include cost and profit mark-ups. As a result, measuring the provision at insurance rates often results in a higher value.

If transferring the pension provision to an insurer reflects the best estimate of the amount necessary to settle the liability, the pension liability should be measured on that basis. This is the case if the entity has an obligation (legal or constructive) to transfer its pension liability. The entity then effectively no longer has a self-administered pension liability. If there is no obligation to transfer, the provision is not measured at insurance rates.

In practice, pension agreements often stipulate that the employer must transfer the pension liability to a professional insurer at the employee's request. This right of the employee does not in itself, in our opinion, always result in the pension provision being measured at insurance rates. The reason for this is the convergence between a director-major shareholder as an employee and that same person as the employer, e.g. in the situation in which the director-major shareholder owns all the shares in the entity. This director-major shareholder in their capacity as an employee has a right vis-à-vis the same director-major shareholder in their capacity as shareholder of the employer. If this director-major shareholder employer does not agree to a transfer, the director-major shareholder employee will not enforce it. Therefore, in our opinion, it cannot be said that the employer has an obligation (legal or constructive) to transfer the pension liability in that case. This could be different if the director-major shareholder holds less than 100% of the shares. In that case, the director-major shareholder and the other shareholders might not have equal interests as regards the director-major shareholder pension arrangements. In such situations, all the facts and circumstances must be assessed to ascertain whether or not the employer has an obligation (legal or constructive) to transfer the liability.

Tax accounting principles
Unlike in the case of retirement liabilities (see below), the provision for (non-written down) self-administered pension entitlements may not be measured according to tax accounting principles. If the outcome of measurement on the basis of tax accounting principles does not differ materially from measurement according to the Dutch Accounting Standards, the entity may then decide, as a practical expedient, to recognise that amount for the provision on the balance sheet. Whether such difference is material depends on its relative size and on the specific circumstances. If the entire financial statements are prepared on the basis of tax accounting principles, the provision is of course measured on that basis (see Chapters 38 and 39).

Retirement liability: measurement and presentation
A retirement liability formed on the basis of the Self-Administered Pensions (Phaseout) and other Tax-Related Pension Measures Act is a obligation to the director-major shareholder for pension entitlements that have been granted to them and written down. For the sake of simplicity and administrative ease, the retirement liability is measured at its tax base (DAS 271.318b). The tax base of the retirement liability is its tax base for corporate income tax purposes (at the point its nominal value is reduced (*afstempeling*)), less distributions/uses plus interest (at the average U return (*U-rendement*) of the previous year). Considerations cited by the Dutch Accounting Standards Board in this regard are:

- the relatively small difference between the commercial and tax measurement of a retirement liability;
- the circumstance that the expenditures will in all cases be equal to the tax base, even if the parties agree during the term to use the retirement liability (to purchase an annuity product or to commute it); and
- the circumstance that the tax base is generally expected to be higher than the commercial value.

A retirement liability based on the Self-Administered Pensions (Phaseout) and other Tax-Related Pension Measures Act is presented separately under debt (DAS 271.322). See paragraph 19.5.1. for presentation as current or non-current.

18.5.2.4 Foreign pension arrangements

For foreign pension arrangements that are not similar to the design and operation of the Dutch pension system, a provision must be recognised according to the obligation-to-employee approach. The principle used for this may be either:

a. to measure the pension liability using an actuarial measurement method generally accepted in the Netherlands; or
b. to apply, fully and consistently, the standards applicable under US GAAP, IFRS or IFRS-EU on pensions and other post-retirement benefits (DAS 271.321).

Re a. This requires a best estimate of the liability existing at the reporting date for measurement purposes. This estimate can be based on the obligation-to-employee approach, taking into account assets specifically placed with the pension fund to settle the liability. Under this option, recognition, presentation and disclosure follow the procedures used for Dutch pension arrangements. Typically, all additions to and releases of the pension provision are charged and credited to the profit and loss account, respectively.

Re b. In this option, recognition, measurement, presentation and disclosure are consistent with one of the standards mentioned. Depending on the system chosen, actuarial profits and losses are then not recognised in the profit and loss account but rather as 'other comprehensive income' as part of the total comprehensive income (*totaalresultaat*).

One example of 'not similar schemes' is many German pension arrangements for former management that are not financed in a pension fund. This is inconsistent with the direct funding of prorated pension accrual required under the Dutch Pensions Act. In such a situation, therefore, the company creates a provision on the balance sheet for that foreign plan using the obligation-to-employee approach.

For foreign pension arrangements that do compare with the design and operation of the Dutch pension system, the obligation-to-pension fund approach described in paragraph 18.5.1 applies. In particular, this could apply to pension arrangements in the UK and Belgium.

18.6 Presentation and disclosure as regards pension commitments

A liability for the contribution owed to the pension fund is either recognised as a separate liability on the balance sheet (Article 2:375 NCC) or disclosed separately in the notes on the composition of debts. An asset item is recognised in other receivables or prepayments and accrued income. The liability under the obligation-to-employee approach is recognised as a separate provision on the balance sheet under Article 2:374 NCC. A receivable for income due to surpluses in the pension fund is included in other receivables or prepayments and accrued income (DAS 271.322).

Offset
The entity only offsets on the balance sheet an asset against a liability resulting from different approaches to pension arrangements if and to the extent that the entity has a legal or contractual right to use a surplus according to one approach to settle the shortfall according to the other approach and it has a firm intention to settle the obligations on a net basis or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.

Profit and loss account
Pension expenses calculated on the basis of DAS 271.3 is either recognised separately in the profit and loss account (as part of the operating profit or loss) or disclosed in the notes (DAS 271.323) pursuant to Article 2:377 NCC.

Additional information
The entity should include the following additional information in the notes (DAS 271.324):

- the principles applied to determine equity and profit or loss in relation to pension expenses and pension provisions;
- a description of the principal features of the pension arrangements, including at least the pensionable salary (final pay, average pay, etc.) and the arrangements regarding indexation of accrued entitlements and rights;
- a description of the principal features of the administration agreement(s) (the Netherlands) or similar financing arrangements (abroad);
- how pension arrangements are administered by the pension fund;
- the applicable funding ratio at the reporting date (or an estimate of it) of the pension fund where the plans are administered;
- the pension contribution recognised in the profit and loss account;
- a description of the liabilities existing at the reporting date for which a pension provision has been recognised;
- the method used to measure the pension provision recognised at the reporting date;
- the principal actuarial principles used, if applicable:
  - the discount rates used;
  - the mortality rates used;
  - any other significant principles used and assumptions made;
- a movement schedule of the pension provision showing the principal movements;
- additional pension expenses recognised in the profit and loss account;
- a description of the principal elements of the pension fund's recovery plan, at least addressing the impact of any deficit on future contributions;
- the pension receivable recognised on the balance sheet and the related effect in profit or loss, including considerations that led to the recognition of the receivable.

18.7 Early retirement and other non-activity arrangements

Characteristics of employee early retirement plans and other non-activity arrangements are in general (DAS 270.401):

- the discretion that employees have whether or not to use the arrangement;
- a temporary benefit that is linked to the employee's most recently earned salary and runs until the retirement date;
- a certain connection with the employee's past service;

- limited duration of the arrangement.

The above shows that early retirement plans and other non-activity arrangements are different in nature from pension arrangements with flexible commencement dates, e.g. pre-pension arrangements. Recognition of pre-pension arrangements in the financial statements is as described in paragraph 18.6.

The liabilities under early retirement plans and other non-activity arrangements recognised in the financial statements should include at least the liabilities to (DAS 271.402):

- employees who have already opted to use the arrangement;
- employees who may opt for early retirement under the existing arrangement but have not yet done so; and
- those employees who are not yet able to opt, but may do so in the future during the term of the existing arrangement.

The entity's obligations as regards early retirement plans include not only ones enforceable in law but also obligations in situations where the entity has no real alternative but to fulfil them (constructive obligations). This could be relevant in the case of an extension of the early retirement plan, or the conversion of the early retirement plan into a pre-pension arrangement.

Reference is generally made to DAS 252 on provisions (measurement based on the 'best estimate' principle) as regards calculating the liabilities recognisable for early retirement plans and other non-activity arrangements. Elements of such calculations are (DAS 271.403):

- employees to whom the arrangement applies;
- the estimated probability of employees opting to use the arrangement;
- the ages, salaries and life expectancy of the employees included in the calculation;
- the early retirement benefit amounts;
- any additional expenses remaining for the entity (e.g. contributions for continued pension accrual);
- government grants and employee contributions; and
- the interest rate used to calculate present value.

Early retirement scheme (Regeling vervroegde uittreding or RVU)
If an arrangement qualifies as an early retirement scheme, the employer owes a penalty tax of 52% on the benefit. This tax, also known as the RVU levy, therefore discourages the award of benefits or provisions to employees to bridge the time until they retire or reach state pension age.

However, according to the Pension Agreement reached in June 2019, employers are temporarily (i.e. from 1 January 2021 to 31 December 2025) exempt from this RVU levy in the case of employees who still have three years or less to work before their state pension age and where the benefit paid to them does not exceed the RVU threshold exemption of EUR 26.184 gross per annum (this amount applied in 2024 and it is indexed annually). This allows employers and employees to make fiscally advantageous early retirement arrangements. This early retirement exemption is a temporary arrangement that applies until 2025 and has since led to the inclusion of early retirement plans in several collective agreements. The details of the arrangement may vary from one collective agreement to another. This mainly involves the definition of the target group (i.e. which jobs are eligible under the collective agreement) and the minimum number of years an employee has to have worked for the employer or in the sector in question. In addition, some collective agreements shorten the benefit period (e.g. to 24 months) or make it dependent on the number of years of service the employee has worked in the sector. The question, of course, is how such an early retirement non-activity arrangement should be recognised in the financial statements. We illustrate this using the example shown below.

Example: Recognition of an early retirement scheme

According to the collective agreement used in a certain healthcare sector, employees who have worked in the sector for at least 40 years may qualify for the maximum benefit allowed for tax purposes for up to 36 months before reaching the state pension age. This benefit is payable by the employer if the employee is in its service when they qualify for the arrangement. An employee can therefore have worked for another employer for 39 years and just one year for the employer who has to pay the benefit. In principle, the employer may not refuse the benefit if the employee invokes early retirement arrangement. It also runs until 31 December 2025. Employees may qualify if their 40-year service in the sector falls before 31 December 2025, in which case they may be eligible for it for three years up to their state pension age.

We now distinguish two groups of workers:

- employees who meet this service requirement at the reporting date and who opt to use the arrangement (not opting in means continuing to work until state pension age); and
- employees who do not yet qualify for the arrangement at the reporting date but who may opt to use it from the point that they do and for as long as it is available, i.e. until the end of 2025.

Clearly, for the first group of employees, the employer must make a provision equal to the best estimate of the benefits, as those employees will no longer render any services in return for the benefit. The entry into force of this collective agreement actually creates an immediate obligation under a non-activity arrangement included in it, which the employer cannot refuse.

For the second group of workers, the accounting treatment is more complex. Let us assume that this group of employees has to work for another two years before they qualify for the scheme. Two views are then possible:

- Given the lack of a relationship between employment (with the specific employer) and the benefit, the obligation is linked to the entry into force of the collective agreement. At that point, a best estimate will be made of the total number of employees expected to opt into the arrangement and the resulting total benefit expense. The employer recognises a liability at present value for this total benefit expense. This liability accrues annual interest and is then recalibrated based on the then current best estimate; or
- Given that the arrangement is still conditional for this group of employees, and this condition is that the employees in question remain in service until the arrangement enters the benefit phase, the best estimate of the total benefit expense is recognised as a liability spread over 24 months over the remaining period of service. This effectively means that the obligation will be linked to the services that employees are still required to provide from the time when the arrangement enters into force in order to qualify for the benefit.

18.8 Remuneration of management board members and supervisory board members

Definition
Only a natural person or a legal person who is or used to form part of the management board within the meaning of Book 2 NCC, i.e. the managing body under the articles of association, is to be regarded as a management board member or former management board member of an entity. A job title (e.g. management board member) does not in itself mean that the person in question is regarded as a management board member within the meaning of the law. (DAS 271.0). A current or former supervisory board member is a person entrusted or formerly entrusted with supervising the management board under the articles of association (DAS 271.0).

Remuneration means (DAS 271.0):

- short-term employee benefits. These include all regularly payable or available benefits other than long-term benefits and termination benefits. Short-term employee benefits include salaries, sick and holiday pay, allowances in kind etc.;
- long-term benefits. These are benefits paid while an employee continues to be employed. They include expenses incurred by the entity for retirement obligations, early retirement plans, 'jubilee' benefits, continued payment of salary (or part of it) during sabbaticals, the right to supplementary social benefits, etc;
- termination benefits. These are benefits payable by an entity following a resignation. They include court-ordered benefits pursuant to proceedings to terminate a management board member's employment, golden handshakes and the like; and
- profit-sharing and bonus payments. This includes payments generally linked to the fulfilment of certain requirements, such as the achievement of a pre-agreed profit or an assessment by a person entrusted with deciding on the award of the remuneration. These include benefits linked to joining the entity.

Annex 1 to this chapter lists examples (taken from DAS 271 Appendix 3) of different types of remuneration covered by Article 2:383 NCC, divided into these four categories.

Legally required disclosures - general
In the remainder of this paragraph, we first discuss the legal requirements applicable to all entities. At the end of this paragraph, we briefly discuss the additional requirements for unlisted 'open' public limited liability companies (i.e. companies with freely transferrable shares) and listed public limited liability companies, respectively. Entities covered by the financial statements regime for small entities and entities applying the group exemption provided by Article 2:403 NCC need not disclose remuneration paid to management board members and supervisory board members.

Pursuant to Article 2:383(1) NCC, remuneration (including pension expenses and other benefits) paid in the aggregate to management board members and former management board members and, separately, remuneration paid in the aggregate to supervisory and former supervisory board members that has been charged to the entity in the financial year is disclosed. If applicable, this should include any adjustment to or claw-back of bonuses or profit sharing.

Remuneration by category (any of the four categories mentioned at the beginning of this paragraph) is disclosed only by 'open' public limited liability companies and listed public limited liability companies, respectively. As regards other entities, renumeration by category is relevant in order to ascertain whether or not disclosure of a payment is legally required.

If the entity has subsidiaries or consolidates the financial data of other companies, the statement must include any charges made to them during the financial year for the management board members and supervisory board members of the consolidating entity (Article 2:383(1) NCC).

Any amounts received from subsidiaries or other consolidated companies by current and former management board members and by current and former supervisory board members that have been remitted to the entity are no longer charged to the profit and loss account and are therefore disregarded in their determination (DAS 271.603). This is therefore the situation in which the entity's current and former management board members and current and former supervisory board members repay any amounts received from other group companies to the entity. In this situation there is no element of remuneration on balance, and, from a consolidated perspective, there is no outflow of funds to the entity's current and former management board members or current and former supervisory board members. Of course, on the basis of Article 2:383(1) NCC, the entity must disclose the benefits the entity itself pays to its current and former management board members and current and former supervisory board members.

The above provisions on legally required disclosures of remuneration do not apply to consolidated financial statements (Article 2:410(1) NCC). This exception is designed to avoid duplicate entries. However, the legally required disclosures can be made in the notes to both the company-only financial statements and the consolidated financial statements. Given the purpose of this legal requirement, disclosing the said information solely in the notes to the consolidated financial statements is considered sufficient (DAS 271.605).

The Dutch Accounting Standards also recommend splitting the total remuneration of management board members by specifying the totals paid to current and former management board members, respectively (DAS 271.605).

If a supervisory board member's work entails issuing opinions to the extent that significantly exceeds the workload usually associated with that position and is otherwise performed by third parties, the fees for such additional work need not be recognised as remuneration (DAS 271.604).

Remuneration not (or only partly) charged to the entity and their connection with the disclosure of related party transactions
It sometimes happens that all or part of the remuneration paid to one or more management board members is not charged to the entity, particularly where a group of companies is involved. This is a related party transaction not entered into on normal market terms. The fact is that, on normal market terms, compensation is charged for performing management duties as well as for management board members' liability to the entity for which the director performs their duties. Article 2:381(3) NCC requires disclosure of (1) the significant transactions that have been entered into by the entity with related parties that are not under normal market terms, (2) the amount of those transactions, (3) the nature of the relationship with the related parties, and (4) other information about those transactions that is necessary to provide insight into the financial position of the entity. In our opinion, reliance on non-disclosure of directors remuneration based on the non-materiality of the transaction (Article 2:381(3) NCC) cannot succeed because, according to Article 2:363(3) NCC, remuneration of management board members' fees may not be omitted and it must therefore be disclosed. Indeed, without this obligation, in many entities, remuneration of

management board members would fall below the materiality threshold or could be considered negligible in the financial statements as a whole (Article 2:363(3) NCC).

Disclosure is required, for example, if remuneration paid to the entity's management board members is wholly or partly reimbursed, or paid directly, by another group entity (e.g. the head of the group). As the *amount* of the transactions that are not entered into on normal market terms must be disclosed (Article 2:381(3) NCC), in that case, the amount reimbursed or directly paid by another group entity must be disclosed. Accordingly, if a natural person who is a director of an entity (together with the parent entity forms the statutory board of this entity) receives remuneration of 150.000 by virtue of his directorship, and this amount is borne by the parent, the entity shall disclose this amount and the fact that the entire remuneration is paid by the parent and not charged to the entity. Although in this situation it can be argued that this remuneration was not (on balance) borne by the entity itself, it has to be disclosed because it involves a related party transactions in combination with the fact that disclosures on management board members' remuneration are mandatory. The purpose of the law is that compensation paid to current and former management board members and current and former supervisory board members must be disclosed unless such disclosure is traceable to a single natural person. This also applies if (part of) the director's remuneration of an entity is borne by the parent or another group entity.

Exemption from the disclosure of related party transactions and disclosure of remuneration
Related party transactions need not be disclosed if they are between subsidiaries wholly-owned by one or more members of the group (Article 2:381(3) NCC). This exemption also applies to medium-sized private limited liability entities (Article 2:397(6) NCC). See also paragraph 30.3. In our opinion, in such situations, if the remuneration was not borne by the entity (wholly or in part) (1) disclosure of the charge made to the entity and (2) disclosure of the fact that the management board member's remuneration was not borne by the entity (wholly or in part) will suffice. In our opinion, the latter disclosure is required by Article 2:383 NCC, the purpose of which is that compensation paid to current and former management board members and to current and supervisory board members must be disclosed (unless such disclosure is traceable to a single natural person). Where remuneration charged to the entity is not the entire remuneration, that should be made clear to users of the financial statements.

Example: Remuneration of a subsidiary's management board members is paid in part by the Holding Entity (1)

Entity D, a subsidiary of Holding Entity H, employs three management board members. One of the management board members is dismissed by the competent body of D. The termination benefit agreed is paid by H and, is not charged to D. The other elements of the management board members' remuneration are, however, charged to D.

In this situation, the total remuneration of D's management board members includes both regular elements of remuneration and termination benefits. The total remuneration should be disclosed in D's financial statements along with a disclosure of the amount charged to H.

If D is a wholly-owned subsidiary of H or a medium-sized private limited liability entity, D's financial statements must disclose the total remuneration charged to D as well as that a portion of the remuneration is charged to H.

Example: Remuneration of a subsidiary's management board members is paid in part by the Holding Entity (2)

Entity D, a subsidiary of Holding Entity H, employs three management board members. Holding Entity H is a listed entity and pays three management board members of D in shares (*performance shares*) if certain performance-related conditions are met and D continues to employ them for three years. The performance requirements are linked to the work of the part of the group represented by D. This share-related element of benefits is not charged to D but rather to H. D uses the option in DAS 275.103a to not include this plan in its financial statements (see paragraph 28.2).

In this situation, the total remuneration paid to D's management board members includes both the elements of remuneration charged to D and the share-related payment charged to H. The total remuneration should be disclosed in D's financial statements along with an explanation of the amount charged to H.

Let us now assume that the management board members of D are also the management board members of H and perform management duties for both entities. In other respects, the same situation applies. In this situation, at least at the level of H, the total management board members' remuneration will have to be disclosed on the basis of the third sentence of Article 2:383(1) NCC ('If the entity has subsidiaries or consolidates the financial data of other companies, the amounts charged to them in the financial year will be included in the disclosure.'). D's financial statements should then disclose the total amount of management board members' remuneration charged to D together with a statement that the management board members are also employed by H and reference to H's financial statements as regards the total remuneration paid to the management board members.

If D is a wholly-owned subsidiary of H or a medium-sized private limited liability entity, D's financial statements must disclose the total remuneration charged to it as well as that a portion of the remuneration is charged to H.

Incidentally, our conclusion that in both previous examples, the total remuneration should be disclosed in the financial statements of D with an explanation of, the amount that has been borne by H or (in the case D is a wholly-owned subsidiary of H or a medium-sized private limited liability entity) that part of the remuneration has been borne by H, is in line with the requirements under IFRS. Indeed, according to IAS 24.9, remuneration includes all forms of remuneration paid by or on behalf of the legal entity or on behalf of the parent of the entity, in exchange for services provided to the entity.

Another common example, is that the intermediate holding entity is the sole management board member of its subsidiary and does not charge a fee in that regard. We believe that, on the basis of Article 2:381(3) NCC regarding related party transactions, the subsidiary's financial statements should disclose that no amount has been charged to the entity for the management of the intermediate holding entity. This also applies if any supervisory board members of the entity are not paid any remuneration. Pursuant to Article 2:381(3) NCC, the size (being the nil remuneration) of these (non-market) transactions, the nature of the relationship with the related party, as well as other information about those transactions necessary to provide insight into the financial position of the entity must be disclosed.

Example: Remuneration of the subsidiary's management board members' is charged to the Holding Entity

Holding Entity H, is the sole management board member of many entities that are all subsidiaries (such as entity D) of Holding Entity H. H does not charge remuneration to these entities for its management. H is the board member of a large number of subsidiaries that are operationally closely interrelated and actually managed together.

One of H's directors performs the management duties at the subsidiaries.

The financial statements of each subsidiary (D) disclose that no remuneration was charged for H's management. This disclosure is included because there is a related party transaction that was not entered into under normal market terms (Article 2:381(3) NCC).

The financial statements of D must state that no remuneration has been charged to D for the management position of H, even if D is a 100% subsidiary of H or a medium-sized private limited liability entity.

The above example applies even if Holding H is not the sole management board member. See the example below.

Example: Remuneration of a subsidiary's management board members is paid in part by the Holding Entity (3)

Entity D, a subsidiary of Holding Entity H, has three management board members, namely natural persons X and Y as well as Holding Entity H. The remuneration of the natural persons is charged to D. H does not pass on any compensation charges to D for its management work.

The board responsibilities that H carries out at D are performed by one of H's management board members.

The director's remuneration charged to D includes both the remuneration paid to X and Y. It should also be disclosed that D is not charged for the payment attributable to H's management work. This is disclosed because it involves a related party transaction not entered into on normal market terms (Article 2:381(3) NCC).

Even if D is a wholly-owned subsidiary of H or a medium-sized private limited liability entity, D's financial statements must disclose the remuneration charged to it. Additionally, it is disclosed that no remuneration is charged to D for the management position of H.

We note that it does not matter whether H's management work represents a substantial portion of D's overall board responsibilities, or whether these are actually performed almost entirely by X and Y. Indeed, even in that situation, H performs board responsibilities such as co-signing documents that require the signature of all management board members according to the law or articles of association (such as the financial statements). Of course, H also bears management board members' liability.

Aggregated charges passed between group companies
If charges passed between group companies are aggregated for a wide range of services (e.g. IT and accounting work in addition to management work), the remuneration component for management board members (and/or supervisory board members) should be identified and disclosed (DAS 271, Appendix 3). The portion of the management fee charged for the management board work (and/or supervisory board work) is disclosed even if the management board member is an entity. If it is not clear to the reporting entity what part of the package of services provided should be allocated to the management board (and/or supervisory board) work, at least the total amount of the charge passed on should be disclosed, together with an explanation that part of it is for the management board members (and/or supervisory board members) work carried out and the remainder for other services.

Exemption for disclosures traceable to a single natural person
The last sentence of Article 2:383(1) NCC reads: A statement that can be traced to a single natural person may be omitted.'. Unless there is a one-tier board (see below in this paragraph), this exemption can be applied separately to the disclosure of remuneration paid to management board members and to the disclosure of remuneration paid to supervisory board members. The exemption is for a single natural person. This means that if a single entity (e.g. a private limited liability entity) is a management board member of the entity, the exemption does not apply. The exemption also does not apply when there is a change of management during the financial year as a result of which, although one natural person was a director at all times, two persons were directors during the financial year.

According to the legislative history, traceability only applies in very special cases. Traceability to a single natural person may not be 'created' by the entity itself, for example by including a voluntary statement in the financial statements or voluntary provision in the articles of association. The following examples illustrate when there is traceability and the creation of traceability, respectively.

Example: Traceability of management board members' remuneration to a single natural person (1)

An entity voluntarily discloses the benefits paid to its management board members relative to one another.

Is the entity exempt from having to disclose this remuneration?

No. In our opinion, it is at odds with the legislator's intentions for the entity to make remuneration traceable by ('voluntarily') disclosing the relative amounts paid to the management board members in the notes to the financial statements. We therefore take the view that this does not provide grounds for an exemption from disclosure.

Example: Traceability of management board members' remuneration to a single natural person (2)

An entity employs two natural persons as management board members. Its management argues that it is known within the company that one of the management board members does not receive remuneration, meaning that remuneration paid to the other (natural person) management board member is traceable.

Is the entity exempt from having to disclose this remuneration?

The legislative history makes it clear that the exemption is about a general 'public' awareness (i.e. not confined merely to the company of the entity in question) of the management board member's remuneration. The answer will depend on why it should be considered common knowledge. If it is voluntarily disclosed by the entity, the answer is no. In other cases, the answer may be yes.

Example: Traceability of management board members' remuneration to a single natural person (3)

An entity is a management board member of a large entity and receives remuneration. It also charges for other services such as IT and accounting services. There is also another management board member who is a natural person and who also receives remuneration. In its financial statements, the entity discloses the remuneration charged by the entity-management board member as well as any payment made for other services. This entity makes this disclosure on the recommendation of DAS 330.201 ('disclosure of transactions on market terms between related parties'). Legally, however, the entity is not obliged to make this disclosure.

Is the entity exempt from having to disclose this remuneration?

No. We consider that disclosure based on a recommendation in the Dutch Accounting Standards of remuneration paid to an entity-management board member to be a 'voluntary' disclosure.

Example: Traceability of management board members' remuneration to a single natural person (4)

An entity is a management board member of a large entity and does not charge remuneration for its management. There is also another management board member who is a natural person and who receives remuneration. In its financial statements, the entity discloses that no remuneration has been charged for the management of the entity-management board member. The entity makes this disclosure based on Article 2:381(3) NCC – disclosure of non-market transactions between related parties.

Is the entity exempt from having to disclose the management board member's remuneration?

No. The decision that there is no remuneration charged to the entity-management board member for its management duties is a ‘voluntary’ choice. For the exemption to apply, the traceability to a single natural person must not have been ‘created’ by the entity itself.

Example: Traceability of management board members’ remuneration to a single natural person (5)

A natural person owns a personal holding entity (PH) through which they own all the shares in entity Z, a medium-sized entity. PH is the sole management board member of Z and charges Z a management fee. The natural person is a management board member of the PH, which pays him remuneration. PH has no other activities. In line with the legal provisions, PH does not disclose management board members' remuneration in the notes (i.e. it is traceable to a single natural person or the exemption for small entity applies).

Is entity Z exempt from having to disclose the management board member's remuneration?

No. The management fee is remuneration paid to an entity (PH) and not to a natural person. Disclosure of the management fee by entity Z cannot be traced back to a single natural person.

Example: Traceability of management board members' remuneration to a single natural person (6)

A natural person X is a management board member throughout year 1. On 1 July of year 2, a change of management board members takes place; as of that date, natural person Y is appointed as a management board member and X is dismissed. Y is a management board member throughout year 3. Accordingly, in each of the three years, the management board consists of a single natural person. No payments were made to former management board members for these years.

Is the entity exempt from having to disclose the management board members's remuneration?

Only in years 1 and 3 is the entity exempt from having to disclose the management board member's remuneration. During year 2 there are two management board members and the disclosure of the total management board member's remuneration cannot be traced back to a single natural person. After all, it is not known to the public how the total remuneration for year 2 is divided between X and Y. The management board member's remuneration for year 2 must be disclosed in the financial statements for year 2 and as a comparative figure in the financial statements for year 3.

Former management board members

It is possible for a sitting management board member to resign from their management position and continue as an ordinary employee. The question is then whether or not they are a former management board member within the meaning of Article 2:383(1) NCC. The following example clarifies this.

Example: A board member withdraws from the board and continues as an ordinary employee

A private limited liability entity has a change of management board on 1 November of year 1. A is a management board member until 1 November. On 1 November, B will take over as management board member. However, A continues to be employed, as a business unit manager but no longer as a management board member. A receives benefits for this, as do other business unit managers. The question is the point at which A should be considered a 'former management board member' and what portion of their benefits should be disclosed: their benefits for when they were a management board member (10 months) or the benefits paid to them over the whole year.

In this situation, the benefits paid for November and December are not for A's former management work but rather for their work in their new position in the company, for which they are paid the appropriate benefits. In our opinion, remuneration of 'former management board members' means remuneration paid following that management board member's resignation but which is the result of the position of management board member. This includes pension expenses for services rendered as a management board member and continued payments without any services rendered in exchange. The financial statements should therefore disclose the benefits paid during the time that A was a management board member (10 months). The fact is that these benefits are linked to their management work during part of the financial year.

Of course, there is the risk of mixing elements of remuneration here, which could camouflage termination benefits. This would be the case if, for example, a former management board member is allowed to stay on as an adviser without specific responsibilities in return for considerable fixed benefits every year. If these are terms of employment that a normal adviser or employee would not enjoy, the termination component should indeed be disclosed as remuneration of a former management board member.

Disclosure for entities with a 'one-tier board'

One possible provision of the articles of association is that management duties in a public or private limited liability entity are split between one or more executive and one or more non-executive management board members (Articles 2:129a and 239a NCC). This is referred to as the one-tier board model. According to Article 2:383 NCC, the financial statements must disclose the remuneration paid to the joint management board members and the joint supervisory board members. In the case of a one-tier board, the non-executive management board members effectively perform the same responsibilities as supervisory board members. Formally, however, they are part of the management board. The Dutch Accounting Standards Board considers that, when applying Article 2:383 NCC, clear information should be given about the total expenditure on management and the total expenditure for its supervision. DAS 271.605 therefore contains an authoritative statement that, where an entity has a one-tier board, the disclosure of the total sum of management board members' remuneration should clearly specify expenditure on executive and non-executive management board members separately. This is not the case if such disclosure is traceable to a single natural person (executive or non-executive management board member).

Clawback
In certain situations, bonuses and profit-sharing can be adjusted or reclaimed from a public limited liability entity (the 'Clawback Act') (Article 2:135 NCC). Broadly speaking, the 'Clawback Act' contains the following provisions:

- Power to adjust an 'unreasonable' bonus (Article 2:135(6) NCC).
  The body that determines remuneration of management board members is authorised to adjust the amount of a bonus if payment of it would be unacceptable according to standards of reasonableness and fairness. This adjustment is therefore made to bonuses that have not yet been paid. The body that determines remuneration is the general meeting, unless another body is designated by the articles of association (Article 2:135(4) NCC);
- power to claw back all or part of a bonus paid on the basis of incorrect information (Article 2:135(8) NCC).
  The entity is authorised to claw back all or part of a bonus already paid to the extent that that payment was made on the basis of incorrect information. A clawback on this basis falls under the legal provisions on 'undue payment'.

Also compulsory is that unlisted open public limited liability entities must disclose an adjustment or clawback for every management board member individually. This is provided by Article 2:383c(6) NCC. The amounts in question are disclosed as components of the profit-sharing and bonus payments that must be disclosed pursuant to Article 2:383c(1)(d) NCC (DAS 271.607). A listed public limited liability entity must include this in its remuneration statement. Other entities applying Article 2:135(6) or (8) NCC must state the amount of the adjustment or clawback of remuneration in their disclosure of the total remuneration paid to management board members that is required by Article 2:383(1) NCC (DAS 271.605c).

The disclosure of this adjustment or clawback of remuneration must be included in the financial statements for the reporting period in which this amount in question is recognised in profit or loss (DAS 271.607). Recognition and measurement in the financial statements should take into account any uncertainties in relation to adjustments and/or clawbacks.

Legally required disclosures for unlisted open public limited liability entities
According to Article 2:383c NCC, an unlisted *open* public limited liability entity discloses information for each individual management board member and supervisory board member. An unlisted 'open' public limited liability entity is:

- not a public limited liability entity whose articles of association only include registered shares, contain transfer restrictions and do not allow bearer certificates from being issued with the company's cooperation; and
- not a public limited liability entity whose shares (or depositary receipts issued with the cooperation of the entity) are listed on a regulated market as referred to in Article 1:1 of the Dutch Financial Supervision Act (*Wet op het financieel toezicht* ('Wft')).

An unlisted open public limited liability entity discloses the following information in the notes (Article 2:383c NCC):

- the amount of remuneration paid to each management board member. This amount is broken down into short-term employee benefits, long-term benefits, termination benefits, profit-sharing and bonus payments, to the extent that these amounts were charged to the company during the financial year;
- the amount of remuneration of each former management board member, broken down into long-term benefits and termination benefits to the extent that these amounts were charged to the company during the financial year;
- the amount of remuneration paid to each supervisory board member, to the extent that that amount was charged to the company during the financial year; and
- the amount of remuneration paid to each former supervisory board member to the extent that that amount was charged to the company during the financial year.

Article 2:383c(1)(a) NCC refers to 'paid remuneration'. Disclosure under this article does not depend on when the payment actually takes place, but rather on the year in which the benefits in question are charged to the entity. This applies *mutatis mutandis* to the disclosure of 'termination benefits' paid to management board members under Article 2:383c(1)(c) NCC (DAS 271.606).

If the company has paid any remuneration in the form of a bonus to a management board member based wholly or in part on the achievement of targets set by or on behalf of the company, it discloses that. It also states in this regard whether these targets were actually met in the reporting period.

If the company has granted any remuneration in the form of profit sharing or a bonus to a supervisory board member, it discloses this separately, stating the reasons underlying the decision to grant remuneration in such form to that supervisory board member.

If the company has subsidiaries or consolidates the financial data of other companies, the amounts charged to them in the financial year are allocated to the relevant category of remuneration referred to in Article 2:383c(1) to (4) NCC.

A company that grants option rights to management board members, supervisory board members or employees on shares of the company or of a subsidiary must disclose, for each management board member and supervisory board member separately and for the employees jointly, a number of details about that option scheme (Article 2:383d NCC). Paragraph 28.12.2 explains what information is required.

In its management board report, an unlisted open public limited liability entity also discloses the company's policy on remuneration of its management and supervisory board members and the manner in which it implemented this policy during the reporting period (Article 2:391(2) NCC, last sentence).

Disclosure by listed public limited liability entities
A listed public limited liability entity (i.e. a public limited liability entity whose shares (or depositary receipts issued with the cooperation of the entity) are listed on a regulated market, as referred to in Article 1:1 Wft), does not include the information listed in Article 2:383c NCC for each individual management board member and supervisory board member in the notes to the financial statements. Instead, it does so in a separate remuneration statement. In that separate statement, the listed public limited liability entity includes extensive information on the remuneration of individual management board and supervisory board members setting out all the information referred to in Article 2:135b NCC (including the information listed in Article 2:383c NCC). The notes to the financial statements must then include the information listed in Article 2:383(1) NCC regarding total remuneration paid to management board and supervisory board members.

Concurrence with IAS 24 in consolidated financial statements
If the financial statements of a listed public limited liability entity consist of consolidated and company-only financial statements, the consolidated financial statements must also meet the disclosure requirements of IAS 24 'Related Party Disclosures'. Indeed, under EC Regulation 2002/1606 (the IFRS Regulation), the consolidated financial statements of a listed public limited liability entity must be prepared on the basis of IFRS-EU (see paragraph 1.1.1). IAS 24.17 then requires disclosure of the remuneration of 'key management personnel' involved in the management and supervision of the group entity. IAS 24 defines key management personnel as those persons having authority and responsibility for planning, directing, and controlling the operational activities, directly or indirectly, including persons having the job title 'director'. (IAS 24.9). This is therefore a different, broader, definition than the one given in Article 2:383c NCC, which merely refers to management board members and supervisory board members under the articles of association. The disclosure of remuneration pursuant to IAS 24.17 relates to total remuneration divided into five categories (short-term employee benefits, post-employment benefits, other long-term benefits, termination benefits and share-based payment benefits).

Concurrence with IAS 24 in company-only financial statements under combination 4
In the company-only financial statements of a listed public limited liability entity, depending on the combination chosen, both IFRS-EU and Title 9 of Book 2 NCC can be applied (see paragraph 1.2). If the company-only financial statements apply IFRS-EU (combination 4), the disclosure requirements of IAS 24.17 will *also* have to be met at that level as well as in the consolidated financial statements (IAS 24.3). The key persons in this case are the key persons of the entity itself.

In practice, governance is sometimes centralised in the head of the group, and the group of key persons and the group of management board members and supervisory board members are the same individuals, both in the entity itself and in the consolidation. The remuneration statement may then reconcile the elements listed in Article 2:135b NCC, Article 2:383c NCC and IAS 24. For the user of the financial statements, there are obviously advantages in having all the information regarding remuneration of management and supervisory board members included in a single section of the management board report. In that case, however, the 'related party transaction' paragraph in the consolidated financial statements and the paragraph on remuneration in the company-only financial statements must clearly refer to the remuneration statement. Of course, the entity may also include the IAS 24.17 paragraph separately in the financial statements. If the group of key persons is different from that of the management and supervisory board members, separate disclosure is required in the financial statements.

18.9 Remuneration of senior public and semipublic sector officials

The Standards for Remuneration Act (*Wet normering topinkomens*)' ('WNT') imposes requirements on disclosure in the financial statements by entities and institutions in the public and semipublic sectors of remuneration and termination benefits paid to so-called senior officials and other officers.

In addition to publication of remuneration and termination benefits in the financial statements, the WNT also sets limits on the amount of remuneration and termination benefits paid to senior executives. If the standard is exceeded, any overpayment must be clawed back.

The WNT applies to entities governed by private law:

- that has a company body vested with public authority;
- whose management board members are appointed by a public body or entity governed by public law, or where significant influence over management or policy is otherwise exercised by a public body or entity governed by public law, with the exception of public limited liability companies and private limited liability companies, whose shares are held by a public body;
- specifically referred to in the annexes to the WNT; or
- that have received subsidies(as referred to in the General Administrative Law Act (*Algemene wet bestuursrecht*, 'Awb') for at least three consecutive calendar years which together exceed EUR 500,000 annually and account for at least 50% of the entity's annual revenues, with the exception of public limited liability entities and private limited liability entities that operate for profit.

If an entity comes under the scope of the WNT, the disclosure requirements provided by it apply. In that case, that entity need not include the disclosures of remuneration of management board and supervisory board members discussed in the previous paragraph (DAS 271.701). We estimate that it is only in exceptional cases that entities to which Title 9 Book 2 NCC directly applies (on the basis of Article 2:360 NCC) come under the scope of the WNT. For more information, please refer to paragraph 41.2.4.8.

18.10 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

Small entities are not required to recognise a liability for benefits paid during employment that are linked to the conditional accrual of rights. These include 'jubilee' benefits, sabbatical leaves and similar benefits. Expenses in this regard may be recognised in the year such benefits are paid out or taken. However, this does not apply if the accrual of rights is unconditional. In that case, no exemption applies (DASsmall B14.106a).

Small entities need only include the information required by law in the notes. and may consider disclosing additional information ('over and above the legal minimum') in the notes.

As indicated in paragraph 18.8, small entities are exempt from the legal disclosures on remuneration paid to management board and supervisory board members.

18.11 Significant differences from IFRS

General
Under IAS 19 'Employee Benefits', short-term employee benefits, pensions, other long-term employee benefits and termination benefits are recognised separately. DAS 271 distinguishes between benefits during employment, pensions, early retirement and other non-activity arrangements and termination benefits. This difference can lead to significant differences in the recognition of certain employee benefits.

One example is the accrual of rights to paid leave during employment, such as 'jubilee' benefits and untaken holidays. DAS 271 classifies these as benefits during employment. In this regard, a liability should be recognised according to the 'best estimate' principle. Under IAS 19, such employee benefits are included in other long-term employee benefits if they are not expected to be fully settled within 12 months after the end of the period in which the employment services were rendered. They are then recognised as other long-term employee benefits. This recognition is similar to the recognition of defined benefit plans, except that actuarial profits and losses are not recognised in 'other comprehensive income' (OCI) but rather in the profit and loss account.

Pensions
IAS 19 assumes that pension arrangements are either defined contribution or defined benefit plans. A defined benefit plan must be recognised on the basis of an actuarial pension measurement using the projected unit credit method. This method takes various factors into account, including future salary increases. In addition, actuarial profits and losses are recognised not in the profit and loss account but rather in 'other comprehensive income' (OCI).

Under NL GAAP, an entity can elect to apply the standards applicable under IFRS, IFRS-EU or US GAAP instead of DAS 271.3 in its financial statements. In that case, full and consistent application of these standards to all Dutch and foreign pension arrangements is mandatory. IAS 19 'Employee Benefits' does not provide the option to apply the pension standards applicable under US GAAP.

Treatment under DAS 271.3 differs markedly from this. DAS 271.3 is based on the Dutch situation which strictly separates the responsibilities of the entity, the pension fund and the participants and shares the risk among these parties. In Dutch pension arrangements, a liability is only recognised in the financial statements if there are additional obligations under the administration agreement.

Foreign pension arrangements similar to the design and operation of the Dutch pension system are, under DAS 271.3, recognised and disclosed in line with Dutch arrangements. Foreign pension arrangements that are not similar to the design and operation of the Dutch:

a. are measured according to the best estimate principle based on an actuarial measurement method that is generally accepted in the Netherlands. Actuarial profits and losses are then recognised in the profit and loss account. DAS 271 does not elaborate on which actuarial measurement methods are generally acceptable. The methods regarding the accounting for defined benefit plans under IFRS and US GAAP standards are considered acceptable in any case, because they are consistent with the obligation-to-employee approach; or
b. the standards applicable under IFRS, IFRS-EU or US GAAP on pensions and other post-employment benefits are applied fully and consistently to such arrangements (DAS 271.321). When this option is applied, recognition, measurement, presentation and disclosure are in line with the applied (IFRS or US GAAP) standard.

Future Pensions Act
In all likelihood, pension plans adapted to the Future Pensions Act (*Wet toekomst pensioenen* 'Wtp) will meet the criteria for 'defined contribution plans' because the employer will only be obliged to pay the agreed contribution and cannot be required to make additional payments. Another factor here is that, under the new system, there will no longer be any funding shortfalls or mechanisms for reversing them (such as increases in contributions and top-up payments). In this context, and as indicated in paragraph 18.4.4, the actuarial and investment risks will lie with the participants because ultimately their pension ('benefit') will no longer be defined but will depend on circumstances such as the investment return achieved, life expectancy and interest rates. Recognition under IAS 19 ('defined contribution') will then align with the obligation-to-pension fund approach, eliminating differences between DAS 271 and IAS 19 as regards the recognition of these pension arrangements. Of course, the final verdict on classification in the new pension system can only be given once the Wtp has been fleshed out in pension fund rules and administration agreements between the pension funds and employers.

Annex 1. List of examples of different types of remuneration that come under the scope of Article 2:383c NCC (taken from DAS 271 Appendix 3; included here without footnotes)

Category A: short-term employee benefits

- Wages and salaries
- Continued payments during sickness and holidays
- Social security contributions (employer's share of both compulsory and voluntary contributions) and payroll tax (or similar tax) borne by the entity
- Holiday pay
- Allowances in kind
- Medical care (as component of benefits in kind)
- Provisioning of housing (as component of benefits in kind)
- Provisioning of a company car, partly for private use (as a component of benefits in kind)
- Low-interest loans (as a component of benefits in kind)
- Expense allowances, unless these are reimbursements of costs actually incurred
- Attendance allowances
- Payroll tax (or similar tax) payable on stock options granted if the entity pays such tax

Category B: long-term benefits

- Pension expenses recognised in the profit and loss account:
  - Dutch pension plans and similar arrangements: contributions due for the financial year plus the liabilities to the pension fund recognised as pension expenses in the profit and loss account.
  - Other pension expenses: For defined benefit plans, this is pension expenses recognised in the profit and loss account on the basis of the projected unit credit method. The change in the present value of pension entitlements granted (as part of total pension expenses) is preferably used in this regard.
- Long-term leave/sabbatical
- 'Jubilee' benefits
- Incapacity insurance (or supplements to it)
- Payments made to incapacitated employees
- Benefits in connection with an early retirement plan
- The right to an addition to a social benefit
- Transition payments made for non-renewal of a temporary employment contract if its renewal was already highly unlikely when it was concluded

Category C: termination benefits

- Redundancy arrangements
- Golden parachute arrangements
- Benefits based on the Subdistrict Court formula
- Transition payments made upon termination of an open-ended employment contract
- Golden handshakes
- Payroll tax (or similar tax) payable on termination benefits if the entity pays such tax

Category D: profit-sharing and bonus payments

- Profit-sharing or bonus arrangements
- Tantièmes
- Gratuities
- Share-based payments including stock options, stock appreciation rights (SARs) and phantom stock
- Allowances on joining the entity's service
- Adjustment and clawback of bonuses and profit sharing

19 Debt

19.1 Introduction

General
A debt is a firm and present obligation existing and fixed at the reporting date that is usually settled by payment (DAS 254.0). A liability may arise from a contract or by law. Debt arising from an agreement is a financial instrument (see Chapter 21). If the amount and timing of settlement of a liability are certain, it is a debt to be recognised in the financial statements as non-current or current debt. If the amount and/or timing of settlement is uncertain, but the amount can still be estimated with sufficient reliability, it is a provision. Furthermore, in addition to debt and provisions, there are liabilities that are not recognised on the balance sheet, so-called contingent liabilities (see Chapter 20).

Accruals and deferred income
Article 2:364(4) NCC lists a special category of debt, the accruals and deferred income. Accruals and deferred income are not discussed in detail by the legislator. Accruals and deferred income can be (DAS 258.102):

- amounts received in advance for income accruing to subsequent periods, e.g. for contributions and subscriptions to associations and periodical publishers respectively; or
- outstanding amounts (possibly estimated) in respect of expenses attributed to an elapsed period, such as telephone charges, energy costs, accrued interest on debt and the like.

Accruals and deferred income may also arise if payments have already been received from customers for services yet to be rendered (amounts received in advance).

Accruals and deferred income can be presented included in debt (DAS 258.102). Accruals and deferred income can also be presented as separate liabilities (Article 2:364(4) NCC). The nature of accrued liabilities should be expressed, if relevant for insight. This can be done either by classification on the balance sheet, by specific designation or by further explanation in the notes (DAS 258.102). It is recommended that the current portion of any non-current accruals and deferred income are classified as current debt (DAS 258.102).

Liabilities subject to suspensive or resolutive conditions
There are liabilities subject to suspensive conditions and liabilities subject to resolutive conditions. Depending on the conditions, there may be grounds for recognising a provision, recognising a debt or just disclosing it in the notes.

Liabilities subject to suspensive conditions are not recognised on the balance sheet unless it is probable that the suspensive condition will be met. In that case, a provision should be recognised under DAS 252. A debt shall be recognised at the moment the suspensive condition is met (i.e. after the fulfilment of the suspensive condition), unless the amount is uncertain but can be reliably estimated. In that case the liability will be or remain recognised as a provision. As long as such liabilities are not recognised on the balance sheet, DAS 252 applies to their disclosure (DAS 254.108).

The liability arising from an agreement, of which the performance and consideration occur after the reporting date, does not generally need to be recognised on the balance sheet (DAS 254.109/DAS 115.113). Multi-year financial liabilities are discussed in Chapter 20.

Scope
This chapter deals with the measurement, presentation and disclosure of non-current and current debt. This chapter does not deal with debts that:

- are financial instruments that are part of a trading portfolio and derivative financial instruments (derivatives). These are dealt with in Chapter 21;
- are pension liabilities. These are dealt with in Chapter 18; and
- are insurance liabilities. These are not dealt with in this manual. See DAS 605 'Insurance companies'.

In addition, paragraph 19.3 of this chapter on the measurement of debt does not apply to:

- employee benefit liability, to which Chapter 18 'Employee benefits' applies;

- tax liability, to which Chapter 17 'Income taxes' applies; and
- lease contract liability, to which Chapter 22 'Leases' applies.

However, paragraph 19.5 on the presentation and disclosure of debt does apply to these forms of debt.

19.2 Recognition and derecognition

19.2.1 Recognition

An entity should recognise a financial instrument liability on the balance sheet when a contractual obligation arises (DAS 290.701). In addition, other standards may require a liability to be recognised on the balance sheet, such as a tax debt. If the amount of a liability to be recognised is certain at the reporting date, it is presented as a current or non-current debt (DAS 254.301).

19.2.2 Derecognition

Change in economic reality
A debt should remain on the balance sheet if a transaction does not result in a significant change in economic reality with respect to that debt (DAS 115.109). Such transactions should not, in principle, give rise to the recognition of profit or loss. This situation may arise, for example, if the transaction is to be considered as a financing or refinancing of an already recognised asset from the perspective of economic reality rather than as a sale of that asset.

The assessment of whether there is a significant change in economic reality should be based on those economic benefits and risks that are likely to occur in practice, rather than on benefits and risks that cannot reasonably be expected to occur.

Derecognition
If a transaction takes place that results in all or virtually all risks relating to a debt being transferred to a third party, then that debt should be derecognised on the balance sheet (DAS 115.110). Examples of such transactions are:

- repayment of the loan by the debtor;
- remission of the loan by the creditor;
- nominal repayment of the original loan with the immediate subsequent issuance of a new loan on significantly different terms; and
- modification of the original loan agreement on significantly different terms.

An exchange and modification of loans with significantly different terms should be treated as a settlement of the original loan and the recognition of a new loan. The existing loan is then written down and the new loan is recognised on the balance sheet at fair value. The difference between the carrying amount of the existing loan and the fair value of the new loan is recognised directly in the statement of profit or loss.

19.3 Measurement

19.3.1 Measurement at initial recognition

Debt should be measured at fair value at initial recognition. In an arm's length transaction, fair value at the time of the transaction will equal cost. Transaction costs directly attributable to the acquisition of debt should be included in the measurement at initial recognition (DAS 254.201).

19.3.2 Subsequent measurement

General
Debt should be measured after initial recognition at amortised cost. If there is no premium or discount or transaction costs, the amortised cost is equal to the face value of the debt (DAS 254.202). The face value of a debt is the principal amount stated in the agreement from which the debt was incurred. Penalties due for early repayment should be taken into account if and to the extent that such early repayment has been announced to the creditor or is otherwise certain (DAS 254.203). An example is the early redemption of bonds where a penalty provision is in place.

Borrowing costs, premium and discount
Generally, interest is agreed as a percentage per annum on the principal of a loan. Furthermore, one-off and periodic payments are made that are either partly intended as interest payments or are so closely related to financing that treatment in the financial statements as 'borrowing costs and similar expenses' is acceptable. Examples include premium and discount and their amortisation, repayment premiums, issuing fees and early repayment costs (one-offs) as well as ancillary costs to close a financing (DAS 273.104). Other examples are exchange rate differences on loans to the extent that they can be considered an adjustment of borrowing costs due (see Chapter 4) and borrowing costs included in the lease term in the case of finance leases (see Chapter 22).

Premium and discount are positive and negative differences, respectively, between the amount received from the lender and the principal recognised as debt at the time the loan was taken out. Premium and discount (as well as repayment premiums) should be allocated to successive reporting periods as borrowing costs. This allocation should be made so that, together with the interest payable on the loan, the effective interest is recognised in the statement of profit or loss and the amortisation value of the debt (referred to as amortised cost) is recognised on the balance sheet (on balance). In this way, a systematic allocation of these items to the debit or credit of the statement of profit or loss takes place, which can be regarded as an adjustment to the borrowing cost. Incidentally, linear amortisation is permitted as an alternative when determining amortised cost, if linear amortisation does not give rise to significant differences compared to the application of the effective interest method (DAS 273.201). See also Chapter 27 on recognition of borrowing costs and similar expenses.

Example: Determining amortised cost

At the beginning of year 1, a company issued a bond loan to the amount of 1,000 (fair value at the time of issue, including transaction costs) with a maturity of five years. The loan has a face value of 1,250 and carries an interest rate of 4.7% annualised (= approximately 59 per annum). Repayment of the entire loan will take place at the end of the term.

The effective interest rate is the rate that at the beginning of year 1 results in a present value of 1,000 of the annual cash flows payable as shown in column c in the table below. The cash flow at the end of year 5 is discounted over 5 years, that at the end of year 4 over 4 years etc. Using this equation, it can be calculated that the effective interest rate is 10%. In this way, the discount is amortised over the life of the loan by basing the interest expense on the carrying amount at the beginning of the year.

	Amortised cost at the beginning of the year (a)	Borrowing costs (b = 10% x a)	Cash flows (c)	Amortised cost at year-end (d = a + b - c)
Year 1	1,000	100	59	1,041
Year 2	1,041	104	59	1,086
Year 3	1,086	109	59	1,136
Year 4	1,136	113	59	1,190
Year 5	1,190	119	1,309	-

19.4 Specific liabilities

Finance lease liabilities
Under finance leases, the lease object and the related debt should be recognised on the lessee's balance sheet at the lower of the fair value of the lease object on commencement of the lease contract or the present value of the minimum lease payments. See Chapter 22.

Amounts received in advance
Allocation of amounts received in advance to successive periods should be systematic, e.g. time-proportionate or proportional to the services to be delivered in those periods to customers, which can be considered as revenue received in advance.

19.5 Presentation and disclosure

19.5.1 Presentation of debt

General
By law, debt with a maturity of more than one year (non-current debt) and debt with a maturity of less than one year (current debt) have to be shown separately in the financial statements. Pursuant to Article 2:375(1) NCC, debt must be split into the following categories:

a. bond loans, pledges and other loans with separate mention of convertible loans;
b. debt to banks;
c. advance payments received on orders to the extent not already deducted from asset items;
d. debt to suppliers and trade credits;
e. bills of exchange and cheques payable;
f. debt to group companies;
g. debt to entities and companies that have a participating interest in the entity or in which the entity has a participating interest, insofar as not already mentioned under f;
h. debt relating to taxes and social security contributions;
i. debt related to pensions; and
j. other debts.

These categories should be included for both non-current and current debt in the financial statements.

Debt (including debt without payment terms) should be presented under current debt if it can be claimed within 12 months of the reporting date and under non-current debt if this is not the case (DAS 254.303).

Repayment due within one year
It follows from Article 2:375(6) NCC that the amount of repayments on long-term loans due in the next year must be disclosed separately in the notes, if these repayment amounts are included under non-current debt. For the purpose of legally required insight, the Dutch Accounting Standards Board recommends classifying the amount of repayments on long-term loans due in the next year as current debt. In this way, the insight offered by the balance sheet regarding the liquidity of the entity is enhanced (DAS 254.308).

Netting
Netting of assets against liabilities and equity is not allowed, if they have to be recognised in separate items under Title 9 Book 2 NCC (Article 2:363(2) NCC). Netting of receivables against debt requires the entity (DAS 115.305):

- to have the power of set-off, which means that the entity will have a sound legal instrument; and
- to have the firm intention to settle the balance as such or both items simultaneously.

If an entity meets these conditions, netting must take place. There is no choice to net or not. See paragraph 2.9 for more details on netting of assets and liabilities.

Refinancing
If on the reporting date an entity has a long-term refinancing agreement for a debt, the relevant debt should be classified as non-current debt (DAS 254.304). A debt should also be classified as non-current debt if, at the reporting date, an entity intends and has the right, under the applicable loan terms, to refinance the debt for a term of at least 12 months after the reporting date. If at the reporting date an entity does not have the right under the applicable loan terms to refinance the debt for a term of at least 12 months after the reporting date, but the refinancing has been contractually agreed before the preparation of the financial statements, it is allowed to classify this debt as non-current. The application of this option is then disclosed (DAS 254.305).

Early repayment
If, after the reporting date but before the preparation of the financial statements, the debtor has repaid a long-term loan (or part of it) early or early repayment has been agreed, it is permissible to present (that part of) the debt as current at the reporting date. However, it is also permissible to continue presenting the debt as non-current (DAS 254.306).

Being allowed to present as current the part of a long-term loan repaid early after the reporting date but before the financial statements are prepared is an exception to the general provisions to present debt as either non-current or current. After all, these imply that debt should only be presented under current debt if it can – contractually – be claimed by the creditor within 12 months of the reporting date (DAS 254.303).

Early payability
If, at the reporting date, the loan terms of a long-term loan agreement are not met with the result that the debt becomes immediately payable (early payability), an entity should classify the debt as current. However, if a recovery period has been agreed with the creditor on or before the reporting date and therefore immediate demand for repayment is not possible, the debt should continue to be classified as non-current, provided the recovery period runs for at least 12 months after the reporting date. If agreement on a recovery period is not reached by an entity with the creditor until after the reporting date but before the preparation of the financial statements, such that the loan is not due within 12 months after the reporting date, it is permissible to classify the debt as non-current. The application of this option is then explained (DAS 254.307).

Decree on annual accounts format (*Besluit Modellen Jaarrekening* or *BMJ*)
The BMJ includes formats for the balance sheet. These formats show the distinction between non-current and current debt. Depending on the format chosen, the breakdown by categories should be provided either on the balance sheet itself or in the notes. In the notes and Formats B and R, the breakdown of current and non-current debt may be given jointly, provided that the breakdown is apparent from the notes (article 12(3) BMJ).

Subordination
The item subordinated debt may be shown separately on the balance sheet after provisions if the relevant debt is subordinated to all other debt shown on the relevant balance sheet. Generally, in practice, often only the separate balance sheet qualifies for disclosure of a subordinated loan. Separate presentation on the consolidated balance sheet of the head of the group (or a parent) is considered acceptable only if this loan is subordinated to all other liabilities recognised on the consolidated balance sheet (DAS 254.309).

19.5.2 Notes on debt

Measurement principles
The notes must set out the measurement principles for debt (DAS 254.411/DAS 290.906).

Security
The notes must state, for the total debt, the amount of debt for which security has been provided and in what form this security has been given (Article 2:375(3) NCC). The security provided must be disclosed by type of security (DAS 254.404). Furthermore, there is an obligation to disclose the debt in respect of which the company has committed itself, conditionally or unconditionally, to encumber or not encumber property, where relevant for the required insight (Article 2:375(3) NCC). This provision includes the so-called positive mortgage declaration and the "pari passu" clause.

According to the Explanatory Memorandum to Article 2:375(3) NCC, disclosure of promised (not yet granted) security may be omitted if there is nothing to indicate that the creditworthiness of the entity is nearing a limit, meaning that the stipulations to that effect take on acute significance (DAS 254.404). The intended legally required insight would not be harmed in that case. Nevertheless, the Dutch Accounting Standards Board recommends that pledges and conditional and unconditional encumbrances or non-encumbrances on property, insofar as the amounts involved are significant, should always be disclosed, and in a manner similar to the asserted collateral. If this disclosure is made only when it is of acute significance, it may be too late (DAS 254.404).

Maturity
For the total non-current debt, the amount with a remaining maturity of more than five years should be disclosed (Article 2:375(2) NCC). If repayments due on long-term loans maturing in the next year are included in the non-current debt, these repayment amounts should be disclosed separately in the notes. This disclosure must be made by category of debt (Article 2:375(6) NCC).

Subordination
With regard to debt, the amount of debt that is subordinated in rank to other debt (generic subordination) must also be disclosed, with the nature of the subordination also being explained (Article 2:375(4) NCC). Incidentally, according

to the Explanatory Memorandum to Article 2:375(4) NCC, disclosure of the subordination is only required if the debt in question is subordinated to all other debt. The disclosure of subordination to one creditor, e.g. the banker, is therefore not mandatory (specific subordination).

Guaranteed equity or liable equity capital
In practice, the combination of shareholders' equity and components of debt appears under various names. These components have a certain subordination in rank to other components of loan capital. Neither the law nor the BMJ gives a designation for, for example, guaranteed equity or liable equity capital. The order of items according to formats for the balance sheet usually does not allow for a contiguous listing of items that are part of the guaranteed equity. Sometimes the balance sheet uses asterisk (*) designations or footnotes that refer to the amount of guaranteed equity explained directly below the balance sheet. Either way, the Dutch Accounting Standards Board stipulates that the composition of the guaranteed equity or liable equity capital should be clearly shown in the separate financial statements. Items of a current nature should not be included in the guaranteed equity or liable equity capital (DAS 240.244/305).

For a more comprehensive treatment of the concept of guaranteed equity, see paragraph 14.1.

Interest rate for long-term loans
The interest rate for each group of non-current debt should be disclosed (Article 2:375(2) NCC). This disclosure may further classify the debt in that group with corresponding interest rates and maturities, if this promotes clarity (DAS 254.403).

The interest rate to be disclosed is the rate per annum. Premium and discount, as a result of which the effective interest rate is higher or lower than this annual percentage rate, may be disregarded for this disclosure unless the impact of the premium and discount on the effective interest rate is more than fractional. In that case, information on this should be provided (DAS 254.403).

If a straight line interest rate has not been agreed for the remaining term in favour of different interest rates (variable rate loan), the agreed course of the interest rate should be indicated. If the interest rate is not fixed but depends on the future development of certain factors, the nature of the dependence and/or the factors on which the interest rate depends should be disclosed (DAS 254.403).

Convertible bonds and other loans
Pursuant to Article 2:375(7) NCC, with regard to convertible bonds and other loans recognised on the balance sheet, the conditions of conversion must be disclosed. For the presentation of convertible bond loans, see Chapter 21 on financial instruments.

Conditions attached to non-current debt
It may be agreed that a non-current debt becomes payable immediately or at short notice under certain circumstances, for example as soon as a certain balance sheet ratio or other ratio is exceeded or undershot. If, during the financial year or after the reporting date (but before preparation of the financial statements), debt that was non-current becomes payable immediately or at short notice, further disclosure is required. Disclosure is also required if, upon preparation of the financial statements, although non-current debt has not yet become payable at short notice, that situation is close to being reached. The entity should then explain that event and disclose the main terms and conditions of the debt that are affected (DAS 254.408). Examples of terms and conditions disclosed by the legal entity include:

- the agreed bank covenants, the ratios and the extent to which the entity is close to achieving the agreed ratios;
- the method of calculating the arrangements or (financial) ratios agreed; and
- the possible consequences for the entity if there is a breach of the agreements in the bank covenants.

The aforementioned information may also be relevant in the context of (explaining) the liquidity risk incurred by the entity (see paragraph 21.10.1).

Movement schedule of non-current debt
To provide insight into the development of the balance sheet position of non-current debt, the Dutch Accounting Standards Board has stipulated that a movement schedule of non-current debt must be included in the notes (DAS 254.408a). This movement schedule should be included for each group of non-current debt, including finance

lease liabilities. The movement schedule should indicate which part of each group of non-current debt is current, if it is part of the non-current debt item on the balance sheet. An appendix to DAS 254 contains an example of a movement schedule of non-current debt.

Early repayment
If, after the reporting date but before preparation of the financial statements, the debtor has repaid all or part of a debt early or early repayment has been agreed, it is permissible to present (that part of) the debt as current as at the reporting date. If this option has been used, it should be explained (DAS 254.306).

19.5.3 Presentation and disclosure of accruals and deferred income

Accruals and deferred income can be presented either included in debt or as a separate line item (Article 2:364(4) NCC).

The nature of accruals and deferred income should be expressed, where relevant for the legally required insight, either by classification on the balance sheet, by specific designation or by further explanation in the notes (DAS 258.102).

It is recommended that the current portion of any non-current accruals and deferred income are classified as current debt (DAS 258.102). The position of the Dutch Accounting Standards Board is in line with DAS 254.308 which recommends that for the purposes of legally required insight, repayments on long-term loans due in the next year should be presented under current debt. If accruals and deferred income are presented included in current debt, the notes should indicate the amount that has a maturity exceeding one year (DAS 258.107).

19.6 Exemptions for medium-sized and small entities

Medium-sized entities have no exemptions.

Small entities are not required under Article 2:396 NCC to include a breakdown of debt on the balance sheet (Article 2:375(1) NCC). This applies to both non-current and current debt.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

19.7 Significant differences from IFRS

Financial instruments
With regard to financial instruments (including debt), there are significant differences from IFRS. Chapter 21 looks at these differences.

Refinancing
If at the reporting date the entity does not have the right under the applicable loan terms to refinance the debt for a term of at least 12 months after the reporting date, but the refinancing has been contractually agreed before the preparation of the financial statements, DAS 254 allows this debt to be classified as non-current. IAS 1 'Presentation of Financial Statements' does not allow this alternative treatment. Under IAS 1, the situation at the reporting date determines the classification.

Early repayment
If, after the reporting date but before the preparation of the financial statements, the debtor has repaid all or part of a long-term loan early or agreed early repayment, DAS 254 allows (that part of) the debt to be presented as current as at the reporting date. Under IAS 1, the situation at the reporting date determines the classification.

Early payability
If agreement on a recovery period is only reached by the entity with the creditor after the reporting date but before the preparation of the financial statements, such that the loan is not due within 12 months of the reporting date, DAS 254 allows the debt to be classified as non-current. IAS 1 does not allow this alternative treatment. Under IAS 1, the situation at the reporting date determines the classification.

Repayment due within one year
Repayment on a long-term loan maturing within one year should be presented under current debt according to IAS 1. Pursuant to Article 2:375(6) NCC, presentation under non-current debt is permitted if the amount due within one year is disclosed in the notes. However, DAS 254 states that for the purpose of legally required insight, it is recommended that the amount of repayments on long-term loans due in the next year be classified as current debt.

20 Off-balance sheet liabilities and assets

20.1 Off-balance sheet liabilities

Definition
Off-balance sheet liabilities consist of (DAS 252.0):

a. contingent liabilities: possible obligations arising from events up to and including the reporting date whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events that are not wholly within the control of the entity.
   Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be settled by other parties is treated as a contingent liability of the entity. The entity recognises a provision for the part of the obligation for which an outflow of resources is probable, except where no reliable estimate can be made;
b. unrecognised liabilities: present liabilities arising from events up to and including the reporting date, which, however, are not recognised because:
   - it is not probable that their settlement will result in an outflow of resources embodying economic benefits; or
   - the amount of the obligations cannot be determined with sufficient reliability.

   An example of an unrecognised liability is a claim that a third-party files against the entity for loss or damage suffered, the award of which is highly unlikely, or the award of which is probable or even certain but the amount due cannot be determined with sufficient reliability; and
c. multi-annual financial liabilities: obligations to which the entity is bound for a number of future years, such as those arising from long-term contracts, with the consideration also being paid in those future years.
   Examples of multi-annual financial liabilities include obligations resulting from ground lease, rent, leasehold, leasing, chartering contracts, licensing contracts and so on.

Also, both contracts subject to suspensive conditions and contracts subject to resolutive conditions may result in contingent liabilities (DAS 252.207). Contracts subject to suspensive conditions are contracts that do not take effect until certain events occur. Contracts subject to resolutive conditions are defined as contracts that take effect immediately but expire when certain events occur (DAS 252.0).

Disclosures of contingent liabilities
All contingent liabilities, i.e. contingent liabilities, unrecognised liabilities and multi-annual financial liabilities, must be disclosed in the notes to the financial statements (Article 2:381(1) NCC), as well as all guarantees provided and all liability assumed by the entity (Article 2:376 NCC).

The nature of each category of contingent liabilities must be briefly described in the notes. Where possible, for each category an entity will also disclose the following in the notes as at the reporting date (DAS 252.509):

a. an estimate of its financial impact;
b. an indication of uncertainties regarding the amount or timing of the outflow; and
c. the possibility of any kind of consideration.

This information need not be provided if it is highly unlikely that resources will be required to settle a contingent liability. See also Annex 1 to this chapter for a schematic overview of the recognition of provisions and contingent liabilities. If some or all of the above disclosures are not made because it is impracticable to do so, this must be disclosed (DAS 252.509 and 510).

In highly exceptional cases, disclosure of the information stated at a, b or c above may seriously prejudice the entity's position in a dispute in or out of court. Although the entity need not provide that information if that is the case, it is in fact required to disclose the general nature of the dispute (DAS 252.512).

As soon as it becomes probable that an outflow of resources embodying future economic benefits will occur for a liability not recognised in the balance sheet until that time, a provision or liability is recognised in the financial statements for the period in which that change in probability occurs. This is only different in the highly exceptional circumstance that no reliable estimate of the amount of the liability can be made (DAS 252.513).

Example: Contingent liability

Ten people fell seriously ill after a wedding in the financial year, possibly due to food poisoning by eating company A's products. Legal proceedings have already been initiated against A. A disputes its liability because it does not believe that it sold poisoned food. When preparing the financial statements, A's lawyers are of the opinion that A is unlikely to be found guilty of wrongdoing.

This information means that a contingent liability has arisen, as there are possible obligations arising from events up to and including the reporting date whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events that are not wholly within the control of the entity. In this example, the court judgment is to be considered the uncertain event that is not wholly within A's control. This judgment will determine whether the possible obligation is a liability for A.

Assumption of liability
An entity that has assumed liability for debts or deficits of others must disclose the resulting obligations (Article 2:376 NCC). Such a disclosure need not be made if the balance sheet contains one or more provisions for this purpose. Examples include joint liability as a partner in a partnership (a partnership firm or a professional partnership) and liability as a current or former general partner in a limited partnership.

The payment of other parties' liabilities may also entail legal risks in other ways, for example if a bank guarantee, surety or another guarantee has been provided. Should there no longer be a risk but an obligation to pay, for instance under a contract of suretyship, a provision or debt will have to be recognised.

Chain responsibility
A special type of contingent liability is guarantee commitments of contractors and hirers of labour under the legal provisions regarding chain responsibility. These provisions primarily pertain to joint and several liability for the payment of employee insurance and national insurance contributions and the payment of wage tax and turnover tax when outsourcing work or hiring labour, respectively (DAS 252.109). These contingent liabilities must be disclosed (DAS 252.509).

Assumption of liability for group entities
Obligations assumed on behalf of group entities must be disclosed separately. The best-known example of assumption of liability for a group entity is a written declaration by reason of the group exemption (Article 2:403 NCC). For company-only financial statements this is prescribed in Article 2:376 NCC; for consolidated financial statements more or less the same is stated in Article 2:414(5) NCC. It requires the entity to indicate in respect of which entities (group entities) the entity (the parent entity) has issued a statement of assumption of liability in accordance with Article 2:403 NCC. Such a liability statement is voluntarily provided by a parent entity that has included the financial data of the relevant group entity in its consolidated financial statements and entails that the parent entity assumes liability for debts arising from legal acts performed by the group entity. On this basis, the group entity is exempted from the obligation to publish its own financial statements; the parent entity's liability statement is filed with the Trade Register rather than the group entity's financial statements. See paragraph 1.7 for more information on this group exemption.

Multi-annual financial liabilities arising from long-term contracts
The entity must disclose the significant contingent financial liabilities to which the entity is bound for a number of future years (Article 2:381(1) NCC), such as obligations arising from long-term contracts. In this respect, obligations to group entities must be disclosed separately. Collateral the entity provides for itself, for group entities or for third parties must also be disclosed (in line with Article 2:375(3) NCC). The latter may include pledges, mortgages or the so-called positive or negative mortgage declaration. A positive mortgage declaration is a commitment to provide mortgage security as soon as the creditor deems this necessary. A negative mortgage declaration is a promise to the creditor that no mortgage will be granted to third parties or that it will be granted only with the creditor's consent.

Guarantees for directors and supervisory board members
Guarantees for the joint directors and - separately - guarantees for the joint supervisory board members of the entity must be disclosed (Article 2:383(2) NCC). These are guarantees provided by the entity, its subsidiaries and the entities whose data it consolidates (group entities).

If the entity indemnifies directors and supervisory board members, this will also have to be stated under the aforementioned legal provision. This is the case, for example, where the entity has taken out insurance for directors (and/or supervisory board members) to cover potential directors' liability. If a director additionally agrees with the entity that the entity will also indemnify the director against potential claims for liability of the director that are not covered by the aforementioned insurance, this indemnification will have to be disclosed.

Special categories
The total amount of long-term commitments to make payments to acquire rights of use or other rights, which are not recognised in the balance sheet, must be disclosed in the notes. The disclosure must specify which total amounts will expire after one year and which ones after five years. Similarly, if individual commitments are of particular significance because of their duration and/or size, their nature, amount and duration must be disclosed in the notes (DAS 252.514).

The notes will also disclose the total amount of payments for the purchase or sale of non-current assets to which the entity has committed itself (DAS 252.515), as well as the total amount of obligations arising from purchase and sales contracts related to inventories. The latter amount must only be disclosed in the notes if these obligations represent an unusually large purchase or supply obligation in relation to the normal business size (DAS 252.516).

As regards obligations assumed on behalf of group entities, the notes must disclose separately whether the entity forms a fiscal unity with other group entities for corporate income tax and/or turnover tax purposes (DAS 252.517).

20.2 Off-balance sheet assets

Definition
Off-balance sheet assets are (DAS 252.0):

a. contingent assets: possible assets arising from events up to and including the reporting date whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events that are not wholly within the control of the entity; and
b. unrecognised assets: present assets arising from events up to and including the reporting date, which, however, are not recognised because:
    - their cost or value cannot be reliably determined; or
    - it is not probable that future economic benefits will flow to the entity from these assets.

An example of a contingent asset is an item arising from an agreed sale of a subsidiary at a fixed price - exceeding its carrying amount - subject to the suspensive condition that anti-trust provisions do not apply, while control has not been transferred (DAS 252.212).

An example of an unrecognised asset mentioned by the Dutch Accounting Standards Board is a claim that the entity files against a third party for loss or damage suffered, the award of which is not, or not yet, virtually certain, or the award of which is virtually certain or even certain but the amount to be received cannot be estimated with sufficient reliability (DAS 252.212). However, the question is whether a claim filed against a third party should not generally be classified as a contingent asset. After all, the existence of the receivable (the asset) by virtue of the claim depends on its attribution and the entity usually cannot exert decisive influence on it.

An example of an unrecognised asset that meets its definition is an insurance claim received by the entity for an incurred loss. If the conditions are met, the claim is received. If it is probable that the claim will be received by the entity, it is recognised. If it is not probable no recognition takes place and it is an unrecognised asset (DAS 252.311).

Contingent assets usually ensue from unplanned or other unexpected events that give rise to the possibility that economic benefits will flow to the entity. They are not recognised in the balance sheet as this could result in income being recognised in the profit and loss account that is not sufficiently certain to ever be received. Both contracts subject to suspensive conditions and contracts subject to resolutive conditions may result in contingent assets (DAS 252.209-211).

The distinction between contingent assets and unrecognised assets is relevant in the context of:

- the disclosures; and

- the time of recognition in the balance sheet.

Disclosure of off-balance sheet assets
The notes must disclose the off-balance sheet assets to which the entity is bound (Article 2:381(1) NCC). DAS 252 also provides guidance on disclosing off-balance sheet assets, prescribing that the nature of the off-balance assets be described in the notes (DAS 252.518). For contingent assets, an estimate of the financial impact of the benefits must also be given when it is probable that economic benefits will flow to the entity (if practicable) (DAS 252.518). If some or all of this information is not provided because it is impracticable to do so, this must be disclosed (DAS 252.519).

In highly exceptional cases, disclosure of one or more details may seriously prejudice the entity's position in a dispute in or out of court. Although the entity need not provide that information if that is the case, it is in fact required to disclose the general nature of the relevant dispute (DAS 252.520).

Time of recognition
Contingent assets are recognised in the balance sheet when it is virtually certain that economic benefits will flow to the entity. At that time, the relevant income is also recognised in the profit and loss account (DAS 252.521).

Unrecognised assets are recognised in the balance sheet from the moment the recognition criteria are met, i.e. when:

- it is probable that future economic benefits will flow to the entity from these assets; and
- the cost or value of the assets can be reliably determined.

20.3 Exemptions for medium-sized and small entities

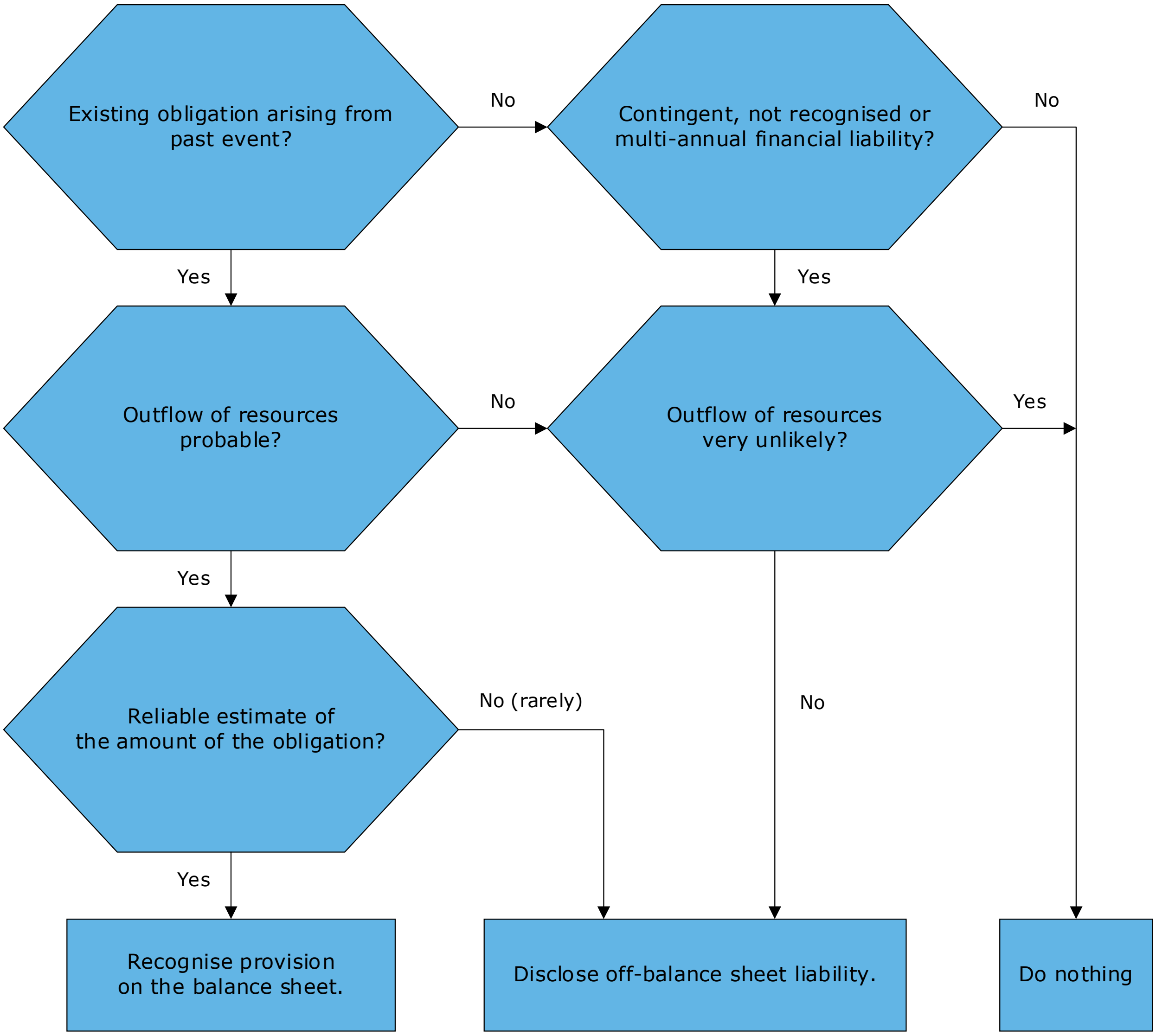
No exemptions apply to medium-sized entities.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

20.4 Significant differences from IFRS

There are no significant differences from IFRS.

Annex 1. Diagram of the recognition of provisions and contingent liabilities (extracted from DAS 252)



21 Financial instruments

21.1 Introduction

The Dutch Accounting Standards Board has set out the rules for accounting for financial instruments in DAS 290 ("Financial Instruments"), which deals with recognition, measurement, determination of profits or losses and the disclosure of financial instruments and includes guidelines for determining the distinction between equity and liability items. DAS 290 further elaborates and explains the legal provisions of Title 9 Book 2 NCC regarding financial instruments.

Other chapters applicable to certain financial instruments also contain provisions for the accounting of financial instruments. For example, the chapters on financial fixed assets, receivables, securities, prepayments and accrued income, cash, equity, debt and leasing.

Financial instruments include both primary instruments, such as receivables, debt and shares, and derivative instruments (also called derivatives), such as financial options, interest rate swaps, futures and forward foreign exchange contracts. Derivatives can be used to hedge or reduce certain risks. An interest rate swap, for example, can be used to convert the floating rate of a long-term loan into a fixed rate, thus hedging the interest rate risk. As for hedge transactions, hedge accounting can be applied under certain conditions. This may be necessary to avoid mismatches that may arise due to a different recognition and/or measurement of hedged items and derivatives.

21.2 Definitions

This paragraph lists and discusses key terms used for reporting financial instruments. These terms are also important in determining when there is actually a financial instrument.

Financial instruments
A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. This definition shows that an asset or liability that does not arise from a contract is not a financial instrument. So there has to be a legal act between two parties. For example, a tax liability is not a financial instrument because it does not arise from a contract but rather directly from legislation.

Financial assets
A financial asset is any asset that is (DAS 290.0):

- cash;
- an equity instrument of another entity;
- a contractual right:
  - to receive cash or another financial asset from another entity (e.g. an account receivable or a loan granted); or
  - to exchange financial assets or financial liabilities with another entity on terms that are potentially favourable to the entity (e.g. a purchased option with a positive value); or
- a contract that will or may be settled in the entity's own equity instruments and is:
  - a non-derivative for which the entity is or may become obliged to receive a variable number of the entity's own equity instruments; or
  - is a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments (e.g. if, when settling a derivative with a positive value, the counterparty transfers a number of shares in the entity equal to the value of the derivative; i.e. a settlement in a variable number of own shares).

Financial liabilities
A financial liability is any liability that (DAS 290.0):

- is a contractual obligation:
  - to deliver cash or another financial asset to another entity (e.g. accounts payable or a loan received);
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity (e.g. a written option with a negative value); or
- a contract that will or may be settled in the entity's own equity instruments and is:

- a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
- is a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's equity instruments (e.g. if the settlement of a derivative with a negative value requires the transfer to the counterparty of a number of the entity's own shares equal to the value of the derivative; i.e. a settlement in a variable number of own shares).

Equity instruments
An equity instrument is any contract that evidences a residual interest in the assets of a party after deducting all of its liabilities. In most cases, ordinary shares qualify as an equity instrument (DAS 290.0).

Derivatives
A derivative is a financial instrument that has the following three characteristics (DAS 290.0):

- its value changes due to changes in market factors such as a certain interest rate, price of a financial instrument, commodity price, exchange rate, price index, credit rating, or other variable (sometimes called the "underlying");
- It requires little or no initial net investment compared to other types of contracts that respond similarly to changes in market conditions; and
- it is settled at a future date.

Derivatives are thus financial instruments derived from an "underlying". Therefore, derivatives are also referred to as "derivative financial instruments".

This definition means that purchase contracts for goods also qualify as derivatives as long as they are settled net. Net settlement means that the goods referred to in the contract are not physically delivered, but that the contract is settled at fair value. See paragraph 21.3.

Contracts which transfer the credit risk of a third party and which are settled on a net basis are generally under the definition of a derivative. For example, credit default swaps where the seller is obliged to make specific payments based on changes in the creditworthiness of another party (the "underlying"), regardless of whether the buyer of the swap is exposed to credit risk in relation to that other party.

Embedded derivatives
An embedded derivative is a component of a compound (hybrid) financial instrument that (DAS 290.825):

- meets the definition of a derivative; and
- is embedded in a host (basic) contract as a contractual condition or group of contractual conditions.

The consequence of the existence of a derivative in a host contract is that some cash flows that are part of the compound financial instrument change in the same way as those of a stand-alone derivative (DAS 290.825). See also paragraph 21.4 regarding the recognition and measurement of embedded derivatives.

Equity-settled financial instruments
Certain financial instruments are settled in the entity's equity instruments. Examples include:

- a receivable that will be settled in own shares of the entity. Here, a distinction can be made between (1) a situation in which the number of shares is fixed and (2) a situation in which the amount is fixed and the number of shares to be received varies depending on their movement in value.
- A debt to a third party that will be paid in shares of the entity itself. Here, too, a distinction can be made between a situation in which the number of shares is fixed (i.e. a variable amount) and a situation in which the amount is fixed.

The question with such types of financial instruments is whether or not there is an equity component. If there is no equity component, a financial asset or a financial liability has to be recognised. See paragraph 21.8 for a more detailed explanation.

Fair value
A key measurement basis when reporting financial instruments is fair value (market value). Fair value is the amount at which an asset can be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction (Article 4 BAW).

If a financial instrument is traded in an active market, the quoted market price is the best indication of fair value (DAS 290.526). Sometimes the quoted market price is not a good indication of fair value. This may be the case if, for example, there is no active market, the market is not well developed or low volumes are traded relative to the number of financial instruments being measured (DAS 290.527).

The fair value of a financial asset or a financial liability derived from the quoted market price or determined by other means does not take into account possible transaction costs for the entity (DAS 290.528). If it is not possible to identify a reliable fair value for financial instruments, e.g. due to the lack of an active market, then, on the basis of Article 10(1) BAW, their fair value is approximated:

- by basing it on the market value of its components or of a similar instrument if a reliable market can be identified for those components or a similar instrument; or
- by using generally accepted measurement models and measurement techniques (DAS 290.524).

When calculating present value, the entity uses a discount rate equal to the prevailing market interest rate for financial instruments with similar conditions and characteristics, including the debtor's creditworthiness, the remaining fixed interest rate period, the remaining term to maturity and the currency stipulated for making payments (DAS 290.527).

Amortised cost
Another common measurement basis for financial instruments is amortised cost. Amortised cost is the carrying amount of the financial instrument at initial recognition on the balance sheet, minus principal repayments, plus or minus the accumulated amortisation using the effective interest method of any difference between the amount at initial recognition and the maturity amount. Any write-downs (direct or through the creation of a provision) due to impairment or uncollectibility are also taken into account (DAS 290.0).

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating interest income and interest expenses to the relevant period based on the effective interest rate. As an alternative to the effective interest method for determining amortised cost, straight-line amortisation is allowed if it does not give rise to major differences compared to the use of the effective interest method (DAS 290.523).

The effective interest rate is the rate that discounts forecast cash payments or receipts through the expected term to maturity of a financial instrument measured at amortised cost or, where relevant, a shorter period, to the net carrying amount of a financial asset or the financial liability.

There is a shorter period if a loan has a variable interest rate, where at certain times the interest rate is revised based on current market conditions. In that case, the effective interest rate is determined until the date of the next interest rate revision. The assumption here is that transaction costs will be charged again at the interest rate revision (either separately or through a mark-up on the interest rate).

The effective interest rate is determined at the time of initial recognition. When calculating the effective interest rate, the entity estimates cash flows, taking into account all the contractual terms of the financial instrument (e.g. prepayment, early repayment and other options), but not future credit losses. This calculation includes all commissions and fees paid or received by the contracting parties which form an integral part of the effective interest rate, as well as transaction costs and all other premiums and discounts. The assumption is that the cash flows and expected term to maturity of a financial instrument or a group of similar financial instruments can be reliably estimated. In the odd case where a reliable estimate of the cash flows of a financial instrument (or group of financial instruments) is not possible, the entity assumes the contractually determined cash flows over the entire contractual life of the financial instrument (or group of financial instruments) (DAS 290.523a).

Example: Amortised cost and effective interest method

On 1 January of year 1, a company buys a bond for the sum of 90; the transaction cost is 5. A mandatory bond repayment of 110 is due on 31 December of year 5. Interest income of 4 (= 3.64% of 110) is received annually during these five years (31 December of year 1 to 31 December of year 5).

	Amortised cost (1/1)	Interest income	Cash flow	Amortised cost (31/12)
Year 1	95.00	6.61	4	97.61
Year 2	97.61	6.79	4	100.40
Year 3	100.40	6.99	4	103.39
Year 4	103.39	7.19	4	106.58
Year 5	106.58	7.42	114	0

The effective interest rate is the percentage that discounts expected cash payments on the bond to the initial measurement at fair value (90) plus transaction costs (5), i.e. 95. The effective interest rate of this bond is 6.96% (95 = 4 / 1.0696 + 4 / 1.0696^{2} + 4 / 1.0696^{3} + 4 / 1.0696^{4} + 114 / 1.0696^{5}). Subsequent recognition is at amortised cost. So amortised cost is effectively the present value of cash receivables based on the effective interest rate. This applies to every reporting date.

Application of straight-line amortisation results in the following interest income and amortised costs:

	Amortised cost (1/1)	Interest income	Cash flow	Amortised cost (31/12)
Year 1	95	7	4	98
Year 2	98	7	4	101
Year 3	101	7	4	104
Year 4	104	7	4	107
Year 5	107	7	114	0

It is not possible to give a direct answer to the question of whether, in this example, applying straight-line amortisation would produce major differences compared to the use of the effective interest method. Answering this question requires an assessment of the impact of applying straight-line amortisation in the context of the entire financial statements.

21.3 Scope of DAS 290

DAS 290 applies to the recognition of financial instruments. Not all financial instruments fall within the scope of DAS 290. The scope of DAS 290 does not include the following financial instruments (DAS 290.202):

- interests in group entities (DAS 214 and DAS 217);
- interests in participating interests in which there is significant influence (DAS 214);
- interests in joint ventures (DAS 215);
- rights and obligations under leases (DAS 292), except for the rules provided in DAS 290 regarding disclosures in relation to such contracts, which do apply;
- equity instruments issued by the reporting entity, except for the provisions in DAS 290 on classification as equity or financial liability, which do apply;
- employers' rights and obligations under employee benefit schemes, which are subject to DAS 271;
- financial instruments from share-based payments, which are subject to DAS 275;
- rights and obligations under insurance contracts (but see also the list below);
- financial guarantee contracts under which the issuer is obliged to make specific payments to compensate the holder for any loss incurred by it due to a specific debtor's failure to perform its payment obligation; these are financial guarantee contracts that do not meet the definition of a derivative (see the table below);
- rights to receive a contingent consideration and obligations to pay a contingent consideration by an acquirer in a merger or acquisition (DAS 216);
- contracts requiring payment based on climatic, geological or other physical variables (no specific standards for this);
- loan commitments if and to the extent that they cannot be settled on a net basis or measured at fair value (no specific standards for this). The disclosure requirements of DAS 290 do apply to such commitments.

This therefore means that DAS 290 does apply to the following, for example:

- derivatives, including derivatives on shares of group entities, derivatives on shares of associates in which there is significant influence and derivatives on shares of the entity's joint ventures;
- participating interests in which there is no significant influence;
- certain contracts to purchase or sell non-financial items (as from now: *commodities*) (see separate treatment below under Commodity contracts);
- rights and obligations arising from insurance contracts that essentially transfer financial risks rather than insurance risks, where such contracts meet the definition of a financial asset, a financial liability or a derivative;
- financial guarantee contracts that meet the definition of a derivative (see paragraph 21.2).

The scope of DAS 290 is very wide with regard to items covered by it. This is illustrated by the following table:

Balance sheet items	**Financial instrument?**	**Within scope of DAS 290?**
Intangible fixed assets	No	N/A
Tangible fixed assets	No	N/A
Participating interests in which there is significant influence	Yes	No
Participating interests in which there is no significant influence, control or joint control	Yes	Yes
Receivables from participating interests	Yes	Yes
Deferred tax assets	No	N/A
Inventory	No	N/A
Trade receivables	Yes	Yes
Receivables from group entities	Yes	Yes
Other receivables	Yes	Yes
Gold	No	N/A
Securities	Yes	Yes
Prepayments and accrued income	No	N/A
Cash	Yes	Yes
Equity	Yes	No, except for the provisions on classification
Pension liabilities	Yes	No
Deferred tax liabilities	No	N/A
Other provisions	No	N/A
Debt to credit institutions	Yes	Yes
Pre-invoiced instalments	No	N/A
Debt to suppliers	Yes	Yes
Debt to group entities;	Yes	Yes
Lease obligations	Yes	No, except for disclosure requirements
Tax liability	No	N/A
Deferred revenue under accruals and deferred income	No	N/A

The following is a list of common balance sheet items accompanied by an explanation, for each item, of why they do not fall within the scope of DAS 290:

Tangible and intangible assets	Due to the definition of a financial asset; i.e. no right to receive cash or any other financial asset.
Prepayments and accrued income	Due to the definition of a financial asset; i.e. no right to receive cash or any other financial asset.
Deferred revenue under accruals; for example, an advance payment received from a client	Due to the definition of a financial liability; i.e. no obligation to pay cash or any other financial asset. The fact is that a service will have to be performed that then produces revenue.

Tax liabilities (deferred tax assets, deferred tax liabilities and tax assets and liabilities)	Due to the definition of a financial instrument; i.e. not resulting from a contract.
Pension liabilities	A debt to the pension administrator falls under the definition of a financial instrument; a pension provision does not. DAS 290 excludes their applicability.
Financial guarantee contracts	If the issuer, i.e. the issuer of the guarantee, is required to make specific payments to compensate the holder for a loss incurred by it because a specific debtor fails to meet its payment obligation, this qualifies as a guarantee obligation that falls within the scope of DAS 252 Provisions, contingent liabilities and contingent assets. However, if the contract meets the definition of a derivative (such as writing an option on a credit default swap), then the contract does fall within the scope of DAS 290.

Commodity contracts
Certain commodity contracts relating to the receipt or delivery of a non-financial asset (commodity) are classified as financial instruments. If such contracts are entered into in accordance with the entity's expected purchase, sales or usage needs, without the parties being entitled to settle on a net basis, these contracts are not considered and treated as financial instruments but rather as normal purchase and sales contracts (DAS 290.202). This provision is based on Article 10(4) BAW, which provides that commodity contracts with a net settlement clause are considered financial instruments unless:

- the commodity contract has been entered into and continues to serve the entity's purchase, sales and usage needs;
- the commodity contract was earmarked for this purpose when entered into; and
- it may be assumed that such commodity contracts will be settled by delivery of the asset.

Net settlement means that the non-financial items are not physically delivered but rather that the contract is settled at fair value. This should take account of economic realities. Net settlement also means:

- the practice of net settlement of contracts resulting in no physical delivery; and
- selling contracts before or shortly after the goods are delivered physically, the aim being to profit from short-term price fluctuations.

21.4 Embedded derivatives

21.4.1 General

An embedded derivative is a component of a hybrid financial instrument that (DAS 290.825):

- meets the definition of a derivative; and
- is embedded, as a contractual condition or group of contractual conditions, in a host contract.

Example: Embedded derivative (1)

A receives a 10-year loan from a bank. According to the loan contract, at the end of the 10-year term, the bank has the right to extend the loan for five years at a predetermined interest rate (an "extendible loan"). The bank will exercise this option if, when extending the loan, it is on terms favourable to it (and therefore unfavourable to A). A has in fact sold (written) an option on an interest rate swap, a so-called swaption. This option is an embedded derivative, as it meets the definition of a derivative and is part of the host contract (the loan contract).

Embedded derivatives are therefore derivatives that are included in a host contract; the financial instrument is therefore a hybrid contract.

Because the host contract includes a derivative, some cash flows resulting from it change in the same way as those from a stand-alone derivative. A derivative linked to a financial instrument but which is contractually independent of it, or involves another party, is not an embedded derivative. This is a separate financial instrument and is recognised according to the normal rules for measuring it and determining the profit or loss.

Example: Embedded derivative (2)

The option to convert a convertible bond loan is an embedded derivative for the holder of the option. A convertible bond loan consists of a loan (the host contract) and an option (the embedded derivative) that gives its holder the right to convert the loan into a fixed number of shares under certain conditions. How such embedded derivatives should be accounted for is discussed below.

For the issuer, such an instrument is classified as a compound instrument because, in its case, the option is classified as an equity component and the loan (the host contract) as a financial liability (debt component). Please refer to paragraph 21.8 as regards the issuer's recognition of such compound instruments.

An important question is whether or not embedded derivatives should be separated from the host contract and recognised separately. The point of separating embedded derivatives is to recognise and measure them separately. The result is that the associated risks are more clearly reflected in the financial statements.

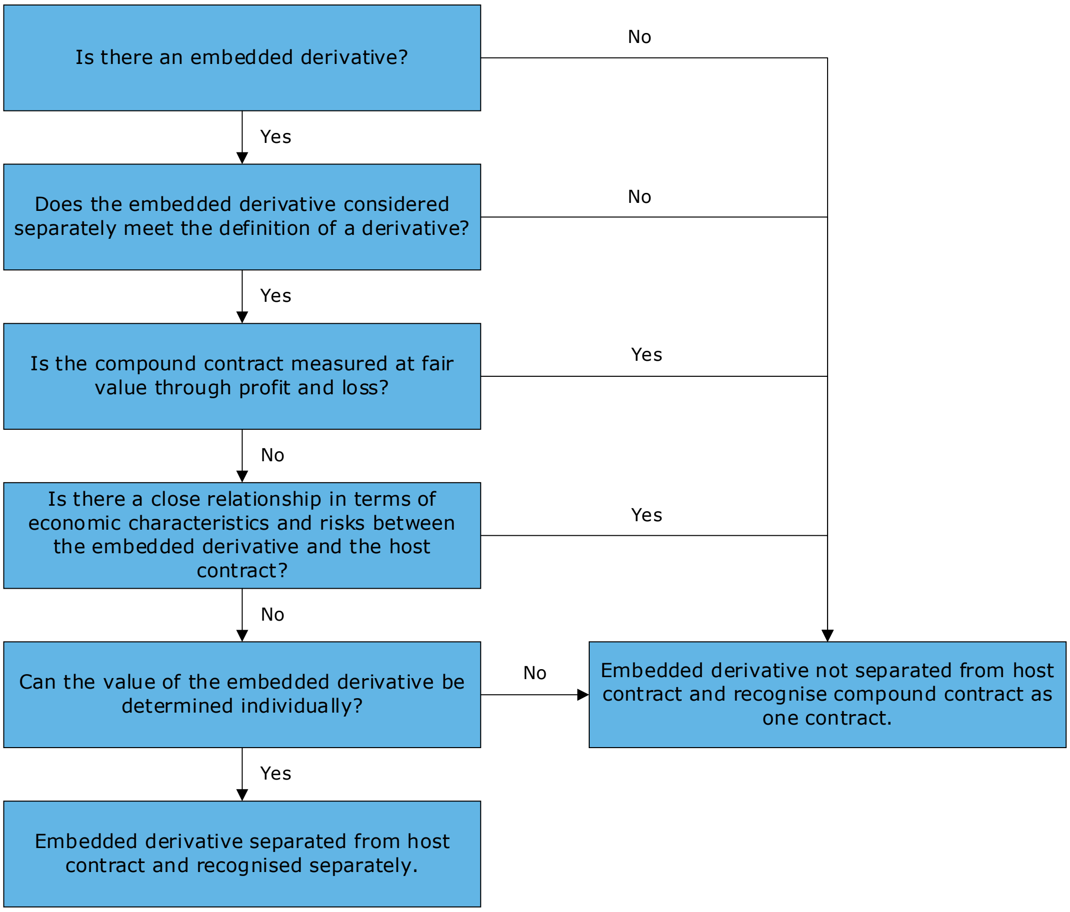
21.4.2 Separation of embedded derivatives

Embedded derivatives have to be separated from the host contract if they meet the following criteria (DAS 290.827):

- a separate instrument subject to the same conditions as the embedded derivative would meet the definition of a derivative;
- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; and
- the compound instrument is not measured at fair value through profit or loss.

The third of these conditions means that if the compound instrument (including the embedded derivative) is measured at fair value through profit or loss, the embedded derivative need not be separated. The fact is that changes in value of the embedded derivative are then already recognised in the financial statements.

Diagram: main rules for separating embedded derivatives (DAS 290.827)



21.4.3 Assessing characteristics and risk profile

One of the conditions for mandatory separation of embedded derivatives is that the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. This condition raises the most questions in practice, as there are no other provisions to determine whether economic characteristics and risks are closely related. However, several examples are included in appendices 4 and 5 of DAS 290 to guide an assessment.

Example: Characteristics and risks of a convertible bond

A convertible bond is a loan subject to the special condition that the holder has the option to convert that loan into shares at any time. In a convertible bond, the risk profile of the loan component lies in its sensitivity to interest rate fluctuations, while the risk profile of the option component (the embedded derivative) lies in its sensitivity to share price fluctuations. Since there is no close relationship between the share price and the interest rate, there is no close relationship between the economic characteristics and risks of the embedded derivative and the economic characteristics and risks of the host contract. The embedded derivative therefore has to be separated from the host contract.

Example: Characteristics and risks of a variable-repayment loan

A loan is repayable at face value plus an amount depending on the gold price. The value of the derivative depends on the gold price and the value of the loan depends mainly on the interest rate. In that case, there is no close relationship between the economic characteristics and risks of the embedded derivative and the economic characteristics and risks of the host contract, meaning that the embedded derivative has to be separated from the host contract.

Example: Characteristics and risks of interest rate caps and floors

Interest rate caps and floors are contracts, also known as interest rate options. The holder of a loan uses an interest rate cap to hedge the risk of an interest rate rise above a certain value ("strike rate") or an interest rate floor to hedge the risk of an interest rate fall below a certain rate. The value of both the loan component (host contract) and the derivative (interest rate cap or floor) depend primarily on the movement of interest rates. There is a close relationship between the characteristics and risks of the host contract and those of the derivative, meaning that the derivative need not be separated from the host contract.

Example: Characteristics and risks of a currency price clause (taken from DAS 290.833)

A Dutch producer enters into a contract to sell goods to a Belgian customer for a price denominated in a non-euro currency, e.g. in US dollars (USD). For both companies, the functional currency is the euro (EUR). If the price is agreed in USD, and USD is *not* customary for contracts for such goods, there is a derivative embedded in the contract. This derivative is a forward foreign exchange contract for the purchase of USD.

In this case, there is no close relationship between settlement in USD and the characteristics of the host contract, including the economic environment in which the transaction occurs and the functional currency of the parties entering into the transaction. The forward foreign exchange contract meets the definition of a derivative. The Dutch producer does not measure the sales contract (the host contract) at fair value through profit or loss. This means that the derivative embedded in the sales contract has to be separated from the host contract.

The host contract is defined as a contract for the sale of goods at a fixed price in EUR and recognised according to the provisions applicable to that contract. The forward foreign exchange contract is then recognised in accordance with the general provisions for measuring and determining the profit or loss of a derivative. At the time of entering into the host contract, the company defines the forward price of the forward foreign foreign exchange contract such that its value at initial recognition is zero.

This example shows that there is no separable embedded derivative if the contract is denominated in the currency of the buyer or seller of the contract, if that currency is used throughout the world for trading in the type of goods traded under the contract or if the currency is normally used in the relevant economic environment (e.g. a high-inflation country uses EUR or USD as its common currency).

DAS 290 also gives the example of a lease which states that the rent of a property increases annually by an adjustment for inflation (DAS 290.834). This adjustment meets the definition of a derivative and the contract is not measured as a whole at fair value through profit or loss. The adjustment for inflation is considered as economically closely related to the lease as long as the inflation feature is not leveraged. Consequently, the embedded derivative (the adjustment for inflation) is not separated from the host contract (the lease).

The Dutch Accounting Standards Board has included the following examples of embedded derivatives in Appendix 5 to DAS 290 'Financial Instruments', explaining whether the embedded derivative should be separated:

Description of instrument	Is there an embedded derivative in the instrument?	Should the embedded derivative be presented and measured separately on the balance sheet?
Convertible bond, classified by the holder as "held to maturity".	Yes, the conversion component is an option for shares.	Yes, the conversion component is not economically closely related to the bond and the convertible bond is not measured at fair value in the profit and loss account.
Convertible bond entered into for trading purposes.	Yes, the conversion component is an option for shares.	No, the convertible bond has already been measured at fair value in the profit and loss account.
Loan taken out where the interest rate depends on the level of the AEX index. The loan is measured at amortised cost.	Yes, an option on the AEX index.	Yes, there is no economic relationship between the derivative and the loan taken out.

Description of instrument	Is there an embedded derivative in the instrument?	Should the embedded derivative be presented and measured separately on the balance sheet?
Loan taken out where the interest rate is set at Euribor.	No.	N/A
A two-year contract to sell a minimum quantity of goods, with lower and upper limits on the price of the goods.	Yes, put and call options in the sales contract for the goods.	No, if the market price at the inception of the contract lies between the exercise price of the call and the exercise price of the put, the derivative and the goods contract are economically closely related.
A two-year contract to sell a fixed quantity of goods at a fixed price adjusted for inflation.	Yes, the adjustment for inflation is an inflation derivative.	No, the adjustment for inflation is closely related to the sales contract for the goods.
A two-year contract under which a company that uses the euro as its functional currency purchases phones from a Japanese company at a fixed price denominated in USD.	Yes, buying in a third currency is a forward contract.	Yes. A forward foreign exchange contract is not separated in the following three instances only: where it is (a) to be measured at fair value in the profit and loss account (including trade), (b) issued in the company's own currency or (c) denominated in the currency of international trade in the territory where the transaction is entered into.
A two-year contract under which a company that uses the euro as its functional currency purchases crude oil from a Japanese company at a fixed price in USD.	Yes, conditions in foreign currency mean this is a forward foreign exchange contract.	No, crude oil is closely related to the USD, as it is traded around the world in USD.
Adjustment for inflation in rent for business premises.	Yes, this is an inflation derivative.	No, inflation derivatives are generally closely related to leases (provided the rent is not adjusted by more than the inflation rate).
A loan with a fixed base rate for the term of the loan and a credit spread. The credit spread is reviewed periodically. This is done based on the credit spread that would be payable in a new loan at the time of an interest rate review (a loan where the interest rate does not fluctuate with the risk-free rate but rather with the price of credit risk).	Yes, the credit spread reset is an embedded derivative.	No, the credit spread reset is closely related to the basic contract. The risk-free rate and the credit spread are both inextricably related to a loan.
An extendible loan where the bank has the right to extend the loan after a number of years for a number of pre-agreed years at a predetermined interest rate. Contractually, the bank has the option to extend. This may entail highly unfavourable conditions to the entity that are impossible to estimate in advance.	Yes, the borrower has sold (written) an option on an interest rate swap, a so-called swaption.	Yes, there is no close relationship between the interest rate swap option (swaption) and the economic characteristics of the loan (host contract). The borrower assumes a risk that, by its nature, is not inseparable from a loan in the case of a written option such as this.
A 30-year loan where the bank has the right to reset the interest rate for the second half of the term at a predetermined fixed rate, or a floating rate. The bank will choose the fixed rate if the market interest rate after 15 years is lower than this predetermined fixed interest rate. The entity could then have to pay an unfavourable interest rate given the then prevailing market conditions.	Yes, the borrower has sold (written) an option on interest, called a swaption.	Yes, there is no close relationship between the written option and the economic characteristics of the loan. The entity assumes a risk that, by its nature, is not inseparable from a loan in the case of a written option such as this.

21.4.4 Recognition of embedded derivatives

The example below illustrates the separation and further recognition of an embedded derivative.

Example: Recognition of a derivative embedded in an extendible loan

A receives a 10-year loan from a bank. According to the loan contract, at the end of the 10-year term, the bank has the right to extend the loan for five years at a predetermined interest rate (an "extendible loan"). In return for this extension option (swaption) written by A, A can negotiate a more favourable interest rate (let us assume 5%) than the market rate (let us assume 5.67%) for the first 10 years. The loan including the extension option has a fair value of 200,000. This is also the amount A receives from the bank when drawing down the loan. Given that the extension option may result in potentially unfavourable interest rate terms for A, that option has a negative fair value of 10,000. The fair value of the loan without extension option is 190,000, which is the present value of the interest and repayment cash flow at the market interest rate. The fair value of the loan without the extension option is lower than the fair value that includes it. This is because a higher interest rate (the market rate) would have to be paid without that extension option. The difference of 10,000 is the (present) value of the interest benefit. This benefit is the consideration (premium) that the bank pays for the extension option which has a negative fair value for A.

As described in paragraph 21.4.3, there is no close relationship between the option (swaption) and the economic characteristics of the loan (the host contract). The derivative is therefore separated from the loan. The journal entry at the time the loan is entered into and drawn down is:

Cash	200,000	
Loan		190,000
Derivative		10,000

The loan is measured at amortised cost. The loan is amortised at 200,000 over its term. Interest expenses in the profit and loss account are determined using the effective interest method. The effective interest rate is the same as the market rate, which is 5.67%. The interest expense recognised in the profit and loss account in year 1 are 10,770 (= 5.67% of 190,000). Interest paid is 10,000 (= 5% of 200,000). The journal entry for the interest payment in year 1 is as follows:

Interest expense	10,770	
Loan		770
Bank		10,000

If the embedded derivative were not separated, the interest expense in the profit and loss account would be 10,000 (= 5% of 200,000).

Upon separation, the derivative is recognised separately. After the loan is taken out, the fair value of the derivative changes due to fluctuations in market interest rates and with the passage of time. If the market interest rate is lower than the predetermined interest rate at the time the loan is extended, the option has a negative value for A, as the bank will then probably exercise its extension option. This means that A will from then on have to pay a higher interest rate than if it were to take out a new loan on the market when the term of the loan ends. If the fair value is more than 10,000 negative (i.e. decreases in value after initial recognition), A must recognise a loss. Let us assume that the option has a negative value of 15,000 at the end of year 1 due to a fall in interest rates. The journal entry is then as follows:

Value change in the embedded derivative (profit and loss account)	5,000	
Embedded derivative		5,000

If the derivative had not been separated, no separate loss due to changes in value of the option would have been recognised. The value of the option would then be included in the measurement of the loan. According to this method, losses on the option (decreases in value) would not be recognised and, consequently, would not be reflected in the financial statements.

The next question is how it would be recognised if the bank exercises (or refrains from exercising) its extension option when the term of the loan ends.

Example: Recognition of an embedded derivative; the bank does not exercise its extension option

The bank will not exercise the extension option if, at the end of the term of the loan, the then prevailing market interest rate is higher than the predetermined interest rate. In that situation, it would not be beneficial to the holder of the option (the bank) to exercise its extension option and, consequently, the fair value of that option is zero.

If the derivative is measured at cost (or lower market value), the option premium (10,000) will be recognised as income in the profit and loss account when the option expires and is not exercised. The journal entry is then:

Embedded derivative	10,000	
Value change of the embedded derivative (profit and loss account)		10,000

We also consider it acceptable, based on the accrual principle, to amortise the option premium to the profit and loss account over the term of the contract (five years).

If A measures the option at fair value, the change in fair value over the life of the option will be recognised in the profit and loss account. If the market interest rate rises, the fair value will fall over the life of the option (a lower fair value for A), eventually trending towards zero. A recognises the change in the option's fair value every year. On expiry, its fair value is zero and therefore no further entry is made. Measurement of the option at fair value might therefore more readily result in profit recognition than when measured at cost (as described above).

Example: Recognition of an embedded derivative; the bank does exercise its extension option

If at the end of the term, the then prevailing market interest rate is lower than the predetermined rate, the bank will exercise the extension option written by A. The extension option is favourable to the option holder (the bank) and, in that situation, the fair value of the option is therefore equal to the intrinsic value (as the time value of the option is zero). In principle, this value is the present value of the interest benefit that the bank obtains by extending the loan at a higher interest rate than the then current market rate. Let us assume that this is an amount of 14,856. A will then measure the option at 14,856, meaning that it recognises a (cumulative) loss of 4,856 (= 14,856 - 10,000). The derivative is recognised on the balance sheet at 14,856 (credit).

Extending the term of the loan by five years at the end of year 10 effectively means paying off the old (existing) loan and taking out a new loan, with both loans having a face value of 200,000. The new loan must be measured at fair value on initial recognition (DAS 290.501). Because the new loan was taken out at a higher interest rate than the market rate at the time, the fair value of the loan is higher than its face value of 200,000. Based on the fair value of the option of 14,856, it can be assumed that the fair value of the new loan is 214,856. The journal entry is then as follows:

Loan (old)	200,000	
Derivative	14,856	
Loan (new)		214,856

The old loan is written down at its carrying amount of 200,000. The extension option is exercised and is therefore also written down, at a carrying amount of 14,856. The new loan is recognised at fair value of 214,856. The interest expense recognised over the term of the new loan will be 14,856 (= 214,856 - 200,000) lower than the notional interest expense, as the loan will be amortised to 200,000 over its term to maturity. Let us assume that the notional interest rate on the loan is 5.67% and the effective interest rate is 4%. The interest expense in year 1 in the profit and loss account is then 8,594 (= 4% of 214,856). Interest paid is 11,337 (= 5.67% of 200,000). The journal entry is as follows:

Interest expense	8,594	
Loan	2,743	
Bank		11,337

The effective interest rate in the profit and loss account is then the market interest rate that applied when the new loan was taken out (4%). In fact, the new loan includes the embedded-derivative liability. This liability will be repaid to the bank over the term of the new loan in accordance with its conditions. The amortised costs of the loan and the interest expense are as follows:

	Amortised cost (1/1)	Interest expense	Interest paid	Amortised cost (31/12)
Year 1	214,856	8,594	11,337	212,113
Year 2	212,113	8,485	11,337	209,260
Year 3	209,260	8,370	11,337	206,294
Year 4	206,294	8,252	11,337	203,208
Year 5	203,208	8,129	11,337	200,000

NB this example does not include transaction costs. Transaction costs must be recognised in the initial measurement of the new loan and they therefore also affect the effective interest rate (DAS 290.501).

21.4.5 Other aspects of embedded derivatives

Hedge accounting
An embedded derivative that is separated from the host contract could qualify as a hedging instrument subject to hedge accounting (DAS 290.827). Obviously, the derivative must then meet the conditions for applying hedge accounting provided in DAS 290.6. See paragraph 21.7.

Fair value not determinable
DAS 290.831 provides that separation is not required if an entity cannot individually determine the fair value of an embedded derivative. In that case, the entire hybrid financial instrument may be measured using the same basis applied in the host contract. This will probably only occur in exceptional instances, as, in most cases, it will be possible to determine or deduce the fair value of the embedded derivative by determining the difference between the fair value of the host contract and the fair value of the compound financial instrument (DAS 290.832).

21.5 Recognition and derecognition

21.5.1 Recognition of a financial instrument

A financial instrument is recognised in the financial statements when the entity becomes a party to the contractual provisions of the instrument (DAS 290.701). This therefore occurs earlier, in principle, than the time when the contracting parties perform. This rule applies to both primary financial instruments and derivatives. Accordingly, entering into a derivative in principle means that the rights or obligations under the contract are recognised on the balance sheet. Incidentally, it is common that the cost of derivatives such as forwards and swaps is zero. If the cost is zero the initial recognition of these derivatives does not yet result in a balance sheet item.

DAS 290 also refers to DAS 115, which contains a number of general conditions for the recognition of items. The consequence of this is that recognising financial instruments also centres on representing the economic reality (DAS 115.107).

Assets
An asset is recognised on the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. An asset is not recognised on the balance sheet if this does not apply (DAS 115.104). An asset must be capitalised if its potential economic benefits and risks lie with the company concerned.

Liabilities
A liability is recognised on the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present liability and the amount at which the settlement will take place can be measured reliably (DAS 115.105). A liability is not recognised on the balance sheet if this does not apply.

21.5.2 Derecognition of a financial instrument

A financial instrument is derecognised if all or substantially all rights to economic benefits and all or substantially all risks have been transferred to an external party (DAS 290.702). For further explanation, DAS 290 refers to DAS 115.1, which contains general provisions about the derecognition of assets and liabilities. These general provisions apply equally to financial instruments.

An asset or liability item recognised on the balance sheet remains on the balance sheet if a transaction does not result in a significant change in economic reality with respect to that item (DAS 115.109). In principle, such transactions do not lead to the recognition of profit or loss. We refer to paragraph 21.6.4.6 on determining amortised cost and the effective interest rate in this situation.

The assessment of whether there is a significant change in economic reality should be based on the economic benefits and risks that are likely to occur in practice, rather than on benefits and risks that cannot reasonably be expected to occur. When assessing risks on an accounts receivable portfolio, the reasonably estimable risk of uncollectibility should be assumed rather than the maximum possible risk. If the legal transfer of the accounts receivable portfolio will not significantly change the actual expected bad debt risk, that portfolio stays on the balance sheet.

An asset or debt item should be derecognised if the transaction results in all or substantially all rights to economic benefits and all or substantially all risks relating to the asset or liability item being transferred to a third party (DAS 115.110).

Example: Sale of accounts receivable portfolio

Company A transfers its entire accounts receivable portfolio to a factoring company. The bad debt risk of this portfolio is estimated at 5% of its face value. The factoring company will carry the risk of uncollectibility if and to the extent that more than 10% of the portfolio is found to be uncollectible. The factoring company is free to sell or pledge the portfolio to another party. Company A therefore has no repurchase obligation.

Based on the risk-return method provided by DAS 115, there is actually no transfer of the portfolio because Company A retains the economic risks of uncollectibility. In this method, the amount received from the factoring company is regarded as credit financing and recognised as debt on the balance sheet.

Example: Transfer of risks and rights in an out-of-the money option

Company A transfers to company B receivables measured at amortised cost (90). It also grants B a put option which will expire after 10 days. B pays 150 for the receivables, which have a fair value of 100. Under the terms of the put option, B can transfer the receivable to A for the sum of 151. The possibility of the fair value of the receivables rising to 151 in 10 days is highly unlikely and, therefore, right from the start, this put option is virtually certain to be exercised.

Since it is virtually certain at the time of granting the put option that the option will be exercised, A did not transfer the principal risks and rights associated with ownership of the receivables. A will therefore recognise the amount received from B for the transfer of the receivables on the credit side of the balance sheet. The contract is in the nature of a secured loan in the amount of 150. The difference between the transfer price (150) and the transfer price according to the put option (151) is amortised using the effective interest method. The receivables that remain on the balance sheet of A therefore provide security to B that A will meet his obligations (the repayment of 151).

Example: Transfer of receivable with retention of risks and rights

Company A transfers current receivables to Company B and guarantees the expected losses on those receivables. A continues to recognise the receivables on its balance sheet because it retains the principal risks and rights associated with ownership of the receivables. A will recognise the amount received from B for the transfer of receivables on the credit side of the balance sheet. The contract is in the nature of a secured debt; in other words, the current receivables provide security to B that A will meet his obligations.

If a transaction results in a significant change in a portion of the economic benefits and risks relating to a previously recognised asset or debt item, the economic reality of the transaction determines the extent to which the asset or liability item is or is not still partly recognised on the balance sheet (DAS 115.111).

Example: Derecognition of financial assets on the balance sheet (1)

Company A has an interest-bearing portfolio of loans granted in the amount of 10,000 with a term of five years to maturity. These loans were granted to individuals. A concludes a contract with C in exchange for a payment of 9,000, agreeing the following:

- A will pay C the first 9,000 (plus interest) of the funds received on the loans;
- A retains entitlement to the last 1,000 (plus interest), i.e. A retains a subordinated residual interest;
- for example, if A is only repaid 8,000 out of 10,000 due to debtor payment problems, it transfers this entire amount to C without any deduction;
- if A is repaid 9,500, however, it transfers 9,000 to C and keeps the remaining 500 itself; and
- the expected loss on the total portfolio is 500.

Although all the repayments on the loans up to 9,000 are transferred directly to C, A has not transferred all or substantially all the risks and rights to economic benefits associated with those loans. The subordinated residual interest absorbs potential differences in net cash flow or expected loss. The legal transfer of part of the portfolio does not significantly change the actual expected bad debt risk. As a result, there is no significant change in the economic reality (DAS 115.109). The total portfolio of loans granted therefore remains in A's balance sheet and A will therefore recognise the amount received from B (9,000) on the credit side of the balance sheet.

If all or part of an asset or liability is derecognised, the profit or loss on this transaction (to the extent relating to the derecognised portion) is recognised directly in the profit and loss account, taking into account any provisions to be made in connection with the transaction (DAS 115.110).

Example: Derecognition of financial assets on the balance sheet (2)

Company A has 1 million in outstanding loans under a contractual interest rate of 10%. A measures these loans at amortised cost. After an impairment of 20,000 the amortised cost of these loans is 980,000. A sells 90% of the loan principal for 900,000, which includes entitlement to interest income of 8%. A must therefore transfer 8% interest to the buyer after receiving any contractually agreed interest payments (10% coupon interest). The portion of the asset transferred meets the criteria for derecognition in every respect.

A retains the right to provide loan-related services. The service contract states that the service provision fee is 1%. A also retains the residual right to interest for the portion not sold. On the date of transfer, the fair value of the retained part of the loan is 100,000, the fair value of the service contract is 15,000 and the fair value of the residual right to interest (margin) is 35,000. The following statement specifies the amounts in which the rights to the loan are retained and sold, assuming the company has already determined that all significant risks and rights relating to the asset have been transferred (e.g. most of the credit losses and most of the interest rate risk on the loans have been transferred).

	Fair value	**Percentage of total fair value**	**Allocated amortised cost**	**Sold right**	**Retained right**
Loans sold	900,000	85.71%	840,000	840,000	
Retained loans	100,000	9.52%	93,333		93,333
Interest	35,000	3.33%	32,667		32,667
Service provision	15,000	1.43%	14,000		14,000
	1,050,000	100.00%	980,000	840,000	140,000

The allocated amortised cost is calculated as a percentage of the fair value multiplied by the amortised cost before transfer (980,000).

The difference between:

- the amortised cost allocated to the divested portion (840,000); and
- the total amount received for the divested portion (900,000)

is recognised in the profit and loss account.

Reverse factoring
A special situation regarding the derecognition of financial liabilities from the balance sheet occurs in 'reverse factoring', also referred to as 'supply chain financing'. *Reverse factoring* is the reverse of factoring because, in this situation, the bank, acting as a factor, pre-finances the entity's trade payables rather than its receivables. That is, after the customer approves the purchase invoices, the bank directly pays the suppliers upon demand. The customer then pays the bank. As long as the principal terms of the trade payables do not change (e.g. payment terms, interest rates and collateral), the customer's balance sheet should still recognise and present the liability as a trade payable. The fact is that there is no significant change in the economic reality. Instead of paying the supplier, the customer now pays the bank, but it is still the case that the amount is paid due to the transaction having been conducted with the supplier. In this case, the bank acts as a payment agent.

If the terms do change materially, the trade payable is effectively replaced by bank financing. This means removing the trade payable from the balance sheet and recognising a debt to the bank instead, in line with the changed economic reality. Thus, 'reverse factoring' requires an assessment of whether the terms change in a material sense. A key critical feature here is the maturity of the debt. If the supplier normally demands a payment within 30 days of the invoice date while reverse factoring extends the term to, say, 210 days, a new financial instrument has effectively been created. Other important features to consider in this assessment include interest rates and collateral. Any difference between the carrying amounts of the trade payable removed from the balance sheet and the fair value of the new bank debt should be recognised in profit and loss when this reclassification occurs. Please refer to paragraph 25.4 as regards the implications for the cash flow classification.

21.5.3 "Trade date accounting" versus "Settlement date accounting"

When buying or selling financial instruments based on standard market conventions, an entity has a choice between recognising them either on the transaction date (trade date accounting) or on the delivery date (settlement date accounting) (DAS 290.703). This choice should then be applied consistently to each category of financial assets and financial liabilities (consistent practice). The transaction date is defined as the date when the company enters into the binding agreement to buy or sell the financial instrument. The settlement date is defined as the date when the asset is delivered or the liability is settled.

Standard market conventions are defined as the settlement period generally prescribed or agreed in the relevant market. As example of a settlement period, DAS 290 gives a bank payment where the date of the instruction for the transfer (the entry date) may differ from the interest date. In the modern payment systems, we see increasingly shorter and even ultra-short periods. With the *Instant Payment* system based on the European standard SEPA, the amount transferred can be credited to the recipient's account within seconds. Of course, this does not apply to banks outside this system, but even then the settlement period will take a few days at most. A settlement period obviously also applies to security transactions where delivery often occurs several days later than the date of the actual transaction. In the market, the convention T+2 working days is often used. In other words, the security should be delivered to the buying party within two working days after the agreement.

If no standard market convention applies, a financial instrument should be recognised on the balance sheet at the time of entering into the transaction; i.e. at the time of entering into the binding agreement. See also paragraph 21.5.1.

With regard to derecognition from the balance sheet, the usual criterion applies that the transaction must result in a significant change in the economic reality. See also paragraph 21.5.2.

In IFRS, the choice to apply trade date or settlement date accounting is limited to the purchase and sale of financial *assets*. In the authorative statement DAS 290.703, this accounting policy choice between trade date or settlement date accounting is also made possible for recognition and derecognition of financial *liabilities*. In particular, this raises an interesting issue regarding no longer recognising on the balance sheet (derecognition) of financial liabilities. We discuss this in more detail in the next section.

Trade date or settlement date accounting when a financial liability is derecognised
Most financial liabilities are settled by means of electronic payment systems. Consider the day-to-day payments of trade payables by means of *payment batches* that include multiple payment orders and are visible in the debtor's bank account after execution by the bank. The question is when there is a *settlement* of a financial liability if it is settled by the electronic payment system. This is especially relevant if it takes a few days before the money is

credited to the creditor's account. The question then is whether this last date should not be a confirmation of the actual *settlement*. In IFRS 9, where the *derecognition* criterion is that the liability must have been legally settled, the date of receipt by the creditor is indeed the most obvious. In practice however, the date on which the amount is debited from the debtor's account and the debtor can no longer reverse this debit either, is used. To provide guidance to the practice, IFRS 9 'Financial Instruments' is now also being amended to make it possible, under certain conditions, for the (trade) liabilities to be derecognised from the balance sheet as soon as the bank has debited the amount from the debtor's account.

Under DAS 290, the situation could already be resolved under trade date accounting because, according to the bank terms, the bank must execute the payment order and thus an agreement is established that the bank must transfer the money to the creditor. Once the order for payment has been given and execution has been made, it is generally impossible to reverse the payment. The fact that the formal *settlement* in this case takes place (for example) two days later is no longer relevant because the company has opted for trade date accounting. It can also be argued from the general criterion of the occurrence of a significant change in the economic reality that the debit on the debtor's own account is sufficient for "derecognition". Based on DAS 290, we therefore see no objection to removing the financial liability from the balance sheet at the time the payment is made by the bank in the electronic payment system.

Recognition at fair value with changes through profit or loss
If the financial instrument is recognised at fair value through profit or loss, the choice between recognising it on the transaction date or on the delivery date makes no difference to profit or loss. The fact is that, if the decision is taken to recognise it on the delivery date, any changes in fair value between the transaction date and delivery date are recognised (DAS 290.706). An asset or liability is then recognised equal to the change in fair value in the intervening period.

Example: "Trade date accounting" versus "Settlement date accounting"

The relevant data of the purchase of a listed share are:

Trade date:	29 December
Reporting date:	31 December
Settlement date:	4 January
Cost of the share:	1,000
Fair value of the share as at 31 December:	1,002
Fair value of the share as at 4 January:	1,003
Measurement:	Measurement at fair value through profit or loss

On 29 December, the share purchase is recognised as follows:

	Trade date accounting		**Settlement date accounting**	
Share	1,000			
Liability		1,000		

On 31 December, the increase in the share's fair value is recognised as follows:

	Trade date accounting		**Settlement date accounting**	
Share	2			
Profit		2		
Receivable			2	
Profit				2

On 4 January, the share's increase in value is recognised as follows:

	Trade date accounting		**Settlement date accounting**	
Share	1			
Profit		1		
Receivable			1	
Profit				1

The settlement of the transaction on 4 January is recognised as follows:

	Trade date accounting		Settlement date accounting	
Liability	1,000			
Cash		1,000		
Share			1,003	
Receivable				3
Cash				1,000

21.6 Measurement and determination of profit or loss

21.6.1 Introduction

DAS 290 is based on the legal provisions on financial instruments. Paragraph 21.6.2 below therefore summarises these provisions. Paragraphs 21.6.3 and 21.6.4 then discuss the measurement and determination of profit or loss of financial instruments under DAS 290.

It is important to note that DAS 290 identifies various categories of financial instruments. Measurement and determination of the profit or loss depend on the category of the financial instrument in question. There is also the possibility of hedge accounting being applied, which bypasses the basic rules. The purpose of hedge accounting is to recognise the profits or losses of the hedging instrument and the hedged item simultaneously in the profit and loss account. This enables risk hedging to be reflected in the reporting.

21.6.2 Legal provisions

The legal provisions on the measurement of financial instruments are set out in Article 2:384 NCC and Article 10 BAW. The law allows financial instruments to be measured at current value, unless Article 10 BAW prohibits this. However, the law also allows financial instruments to be measured at cost (Article 2:384(1) NCC). Measurement of financial instruments at current value is therefore by no means required by law. This applies not only to primary financial instruments but also to derivatives. This is in contrast to IFRS, which requires derivatives to be measured at fair value. Since the cost of certain derivatives, which often serve to hedge financial risks, is often small or zero, they are effectively off-balance sheet when measured at cost. All changes in value are then kept "off-balance sheet". Only falls in value below cost have to be recognised (see paragraph 21.6.4.2). This contrasts with measurement of derivatives at current value, where all changes in value are recognised on the balance sheet.

If financial instruments are measured at current value, their fair value applies (referred to as market value in the BAW). Changes in value in non-derivative financial instruments measured at fair value may be recognised immediately in profit or loss (Article 2:384(7) NCC). Therefore, this is not mandatory. Recognition directly in equity (revaluation reserve) is also permitted by law.

If derivatives are measured at fair value, changes in value are recognised immediately in profit or loss (Article 2:384(7) NCC). This means that, unlike in the case of primary financial instruments, no option is available as regards the recognition of changes in value in derivatives. This provision is waived when applying cash flow hedge accounting (Article 2:384(8) NCC).

Measurement at current value is not allowed (Article 10(3) BAW):

- in the case of primary financial instruments held to maturity (e.g. bonds), with the exception of insurance company investments as referred to in Article 2:442 NCC;
- loans granted or claims to be collected by the entity (e.g. receivables), unless they are part of its trading portfolio or insurance company investments referred to in Article 2:442 NCC; and
- interests in subsidiaries, in associates as referred to in Article 2:389(1) NCC and in entities in which the entity has participating interests under a mutual cooperation arrangement, equity instruments issued by the entity, contracts involving a possible contribution in the context of a cooperation between companies, and other financial instruments with such specific characteristics that, according to generally accepted practice, they are not reported at current value.

Liabilities may only be measured at fair value if (Article 10(2) BAW):

- financial instruments that are part of the entity's trading portfolio;
- derivative financial instruments; or
- insurance liabilities or pension liabilities.

If it is not possible to directly identify a reliable fair value for financial instruments, their fair value is approximated (Article 10(1) BAW):

- by deriving it from the fair value of its constituent elements or of a similar instrument if a reliable market can be identified for those elements or such similar instrument; or
- by using generally accepted measurement models and techniques.

If it is not possible to establish a reliable fair value for financial instruments as described above, they are measured at purchase cost (Article 10(3) BAW).

21.6.3 Measurement at initial recognition

Financial assets and financial liabilities are always measured at fair value at initial recognition (DAS 290.501). Paragraph 21.2 describes how to determine fair value. The next question is how to recognise the transaction costs. This depends on the measurement chosen following initial recognition (the subsequent measurement). This can be summarised as follows (DAS 290.501):

Subsequent measurement	Recognition of transaction costs
Fair value through profit or loss	In the profit and loss account in the initial period of measurement
Fair value directly in equity	In measurement at initial recognition. Upon transfer to third parties or by applying the effective interest method in the profit and loss account
Amortised cost	In measurement at initial recognition. By applying the effective interest method in the profit and loss account

This shows that, in a subsequent measurement at fair value through profit or loss, the entire transaction costs are expensed to the profit and loss account of the period in which the acquisition is recognised. This is not the case for a subsequent measurement at fair value directly in equity or for subsequent measurement at amortised cost. In these subsequent measurements, transaction costs are gradually charged to the profit and loss account as part of the effective interest rate.

21.6.4 Subsequent measurement

21.6.4.1 General

Categories of financial assets
In line with the law, DAS 290 allows most financial instruments to be measured and their profit or loss determined based on both cost and fair value. DAS 290.407 lists the following five categories of financial assets as regards their subsequent measurement and determination of profit or loss:

- financial assets included in the trading portfolio;
- derivatives not included in the trading portfolio;
- purchased loans and bonds not included in the trading portfolio;
- loans granted and other receivables not included in the trading portfolio; and
- investments in equity instruments not included in the trading portfolio.

Measurement of financial assets
Measurement at fair value through profit or loss is prescribed solely in the following cases:

- financial instruments (financial assets and financial liabilities) included in the trading portfolio (DAS 290.508); and

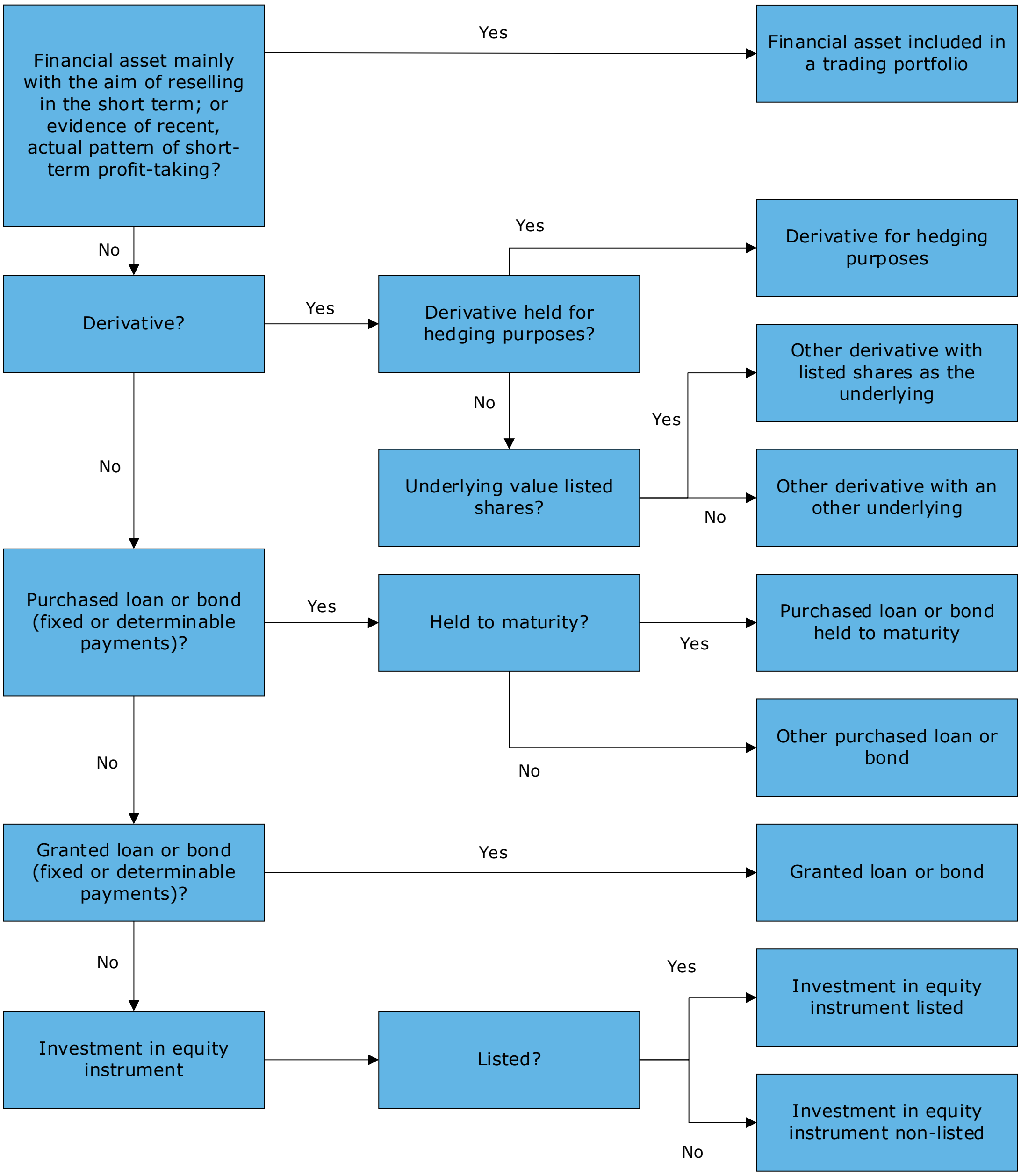
- derivatives with listed shares as the underlying (DAS 290.512).

Measurement at fair value, which allows a choice between recognition of changes in value in the profit and loss account or in equity (revaluation reserve), is prescribed solely for investments in listed equity instruments not included in the trading portfolio (DAS 290.521).

Measurement at (amortised) cost is prescribed for *purchased* loans and bonds held to maturity as well as for loans *granted* and other receivables (DAS 290.515 and 519). For other financial assets, a choice is available between measuring them at (amortised) cost or at fair value in either the profit and loss account or in equity.

Listed bonds may be measured at amortised cost or at fair value through profit or loss or equity (DAS 290.518). This also applies to derivatives with listed bonds as the underlying. If the choice is made to measure these derivatives at fair value, changes in value are recognised in the profit and loss account (DAS 290.513).

The foregoing shows that most of the categories of financial assets can be divided into subcategories for the purposes of subsequent measurement. These different categories and subcategories are shown in the following diagram:



Categories of financial liabilities
DAS 290.4 lists the following three categories of financial liabilities as regards their subsequent measurement and determination of profit or loss, depending on the entity's use of them (DAS 290.4):

1. financial liabilities included in the trading portfolio;
2. derivatives not included in the trading portfolio;
3. other financial liabilities.

Measurement of financial liabilities
Financial liabilities included in the trading portfolio are measured at fair value through profit or loss (DAS 290.508 and 509). This also applies to derivatives not included in the trading portfolio but with listed shares as the underlying. For other derivatives, a choice is available between cost and fair value (DAS 290.512). Other financial liabilities are measured at amortised cost (DAS 290.523).

Individual or portfolio-based classification
Financial assets and financial liabilities should be allocated to categories (or sub-categories) individually or on a portfolio basis. One measurement principle should be used for each category/sub-category (DAS 290.502). Subsequent measurement and determination of profit or loss are directly related to the categories of financial assets and financial liabilities. It is therefore important to know how these categories are defined. There are no special rules for this other than that the categories are defined (DAS 290.4). This should therefore be assessed against the definitions given in DAS 290.4.

21.6.4.2 Statement of subsequent measurement and determination of profit or loss

Subsequent measurement and determination of profit or loss depend on the categories/sub-categories of financial assets and financial liabilities. The following combinations of subsequent measurement and determination of profit or loss may be applied to the various categories (table derived from DAS 290.504):

Category/ Type of financial instrument	Sub-category	Subsequent measurement	Recognition of changes in value
Trading portfolio (financial assets and financial liabilities)		Fair value	Directly in the profit and loss account.
Derivatives (assets and liabilities) (not included in the trading portfolio)	Hedging	Fair value	According to hedge accounting models.
		Cost	Together with the hedged item in the profit and loss account. If the hedged item is recognised at fair value, the entity also accounts for the changes in value of the derivative and applies fair value or cash flow hedge accounting. However, this does not mean that the changes in value of the derivative for the period before hedge accounting is applied is still recognised on the balance sheet.
	Other - with listed shares as the underlying	Fair value	Directly in the profit and loss account.
	Other - with an underlying other than listed shares	Cost	In the profit and loss account upon transfer to a third party or in the event of impairment.
		Fair value	Directly in the profit and loss account.

Category/ Type of financial instrument	Sub-category	Subsequent measurement	Recognition of changes in value
Purchased loans and bonds (not included in the trading portfolio)	Held to maturity	Amortised cost	Effective interest in the profit and loss account. Impairment directly in the profit and loss account.
	Other	Amortised cost	Effective interest in the profit and loss account. In the profit and loss account upon transfer to a third party or in the event of impairment.
		Fair value	Directly in the profit and loss account.
			Initially, directly in equity (revaluation reserve) and, upon realisation, in the profit and loss account. Effective interest in the profit and loss account. Changes in value below (amortised) cost directly in the profit and loss account.
Loans granted and other receivables (not included in the trading portfolio)		Amortised cost	Effective interest in the profit and loss account. In the profit and loss account upon transfer to a third party or in the event of impairment.
Investments in equity instruments (not included in the trading portfolio)	Not included in a trading portfolio - Listed	Fair value	Directly in the profit and loss account.
			Initially, directly in equity (revaluation reserve) and, upon realisation, in the profit and loss account. Changes in value below cost directly in the profit and loss account.
	Not included in a trading portfolio - Not listed	Cost	In the profit and loss account upon transfer to a third party or in the event of impairment.
		Fair value	Directly in the profit and loss account.
			Initially, directly in equity (revaluation reserve) and, upon realisation, in the profit and loss account. Changes in value below cost directly in the profit and loss account.
Other financial liabilities	Not included in a trading portfolio	Amortised cost	Effective interest in the profit and loss account.

Financial assets and financial liabilities included in a trading portfolio
The category 'Financial assets and financial liabilities included in a trading portfolio' includes all financial instruments that (DAS 290.408/414):

- were mainly acquired or entered into with the aim of reselling them in the short term; or
- are part of identified financial instruments that are jointly managed and for which there is evidence of a recent, actual pattern of short-term profit-taking.

These assets were acquired or are being to generate profit from short-term price fluctuations or trading margin. One example of this would be a temporary conversion of excess cash into shares with the aim of achieving short-term profit or loss. Therefore, this category is not reserved for financial institutions but can be relevant in all entities.

Derivatives
Derivatives held for hedging purposes
According to the above table, derivatives held for hedging purposes may be measured at fair value or at cost after initial recognition. The choice of measurement basis may be made per type of hedge relationship (DAS 290.511). For example:

- fair value measurement of derivatives that hedge foreign currency risks on inventories; and
- measurement at cost of derivatives that hedge the interest rate risk on floating rate loans.

Derivatives with an underlying other than listed shares

The chart shows that derivatives with an underlying other than listed shares (e.g. forward foreign exchange contracts and interest rate swaps) may also be measured at fair value or at cost. The option to value at cost is in line with the above discussed legal requirements for the measurement of financial instruments.

If the choice is made to measure this subcategory of derivatives not at cost but at fair value, the gains and losses on the change in fair value are recognised in the profit and loss account. When measured at cost, the gains and losses on these derivatives are allocated to successive accounting periods (DAS 290.513). Of course, this should also take into account any impairment.

Example: Allocation of gains and losses on derivatives

Company A takes out a loan with a variable interest rate. To hedge against a rise in interest expense, A buys an interest rate cap with a 5-year term for 144,000. Given this interest rate cap, A is paid the difference between 5% and EURIBOR on the notional amount of 10 million if EURIBOR exceeds 5%. A values derivatives at cost and does not apply hedge accounting. A recognises in its profit and loss account:

- as income any periodic interest gains on the swap if EURIBOR exceeds 5%;
- as an expense spread over 5 years the sum of 28,800 (144,000 / 5) on a straight-line allocation of the cost paid; and
- as an expense any impairment. This amount will of course be deducted from any cost still attributable to future periods.

Lower fair value of derivatives measured at cost or fair value is negative
An entity may measure a derivative (e.g. an interest rate swap) at cost. However, if the fair value of the derivative falls below zero, there is a loss. This means that a liability must be recognised under the derivative at its negative fair value. The fact is that, according to DAS 290.541, derivatives measured at cost must be impaired to the lower fair value at the reporting date.

Example: Negative fair value

Company A takes out a loan with a variable interest rate. To hedge against the risk of variable cash flows, A enters into an interest rate swap with a five-year term. The cost of this interest rate swap is zero. Under this swap, A receives a variable interest rate equal to EURIBOR on a notional amount of 10 million and A pays a fixed interest rate of 5% on the notional amount of 10 million. A values derivatives at cost and does not apply hedge accounting. On entering into the swap, the swap is measured at fair value on initial recognition, i.e. zero. But EURIBOR falls and A has to pay, on balance, the difference between 5% and EURIBOR. At the reporting date of 31 December, the swap has a negative fair value of 150,000 for A. Under DAS 290.541, A must recognise a loss of 150,000 and the derivative is measured at the negative fair value of 150,000.

The lower fair value is determined without including accrued interest. For forward foreign exchange contracts, it is acceptable to determine the lower fair value by translation at the closing rate (DAS 290.541).

When applying cost hedge accounting, no loss is recognised for the effective portion. For the ineffective portion, the foregoing applies *mutatis mutandis* and does require an impairment to the lower fair value. Paragraph 21.7.4.3 discusses cost hedge accounting in more detail.

Purchased loans and bonds including ones "held to maturity"
The category "Purchased loans and bonds" includes financial assets with fixed or determinable payments acquired from third parties. This therefore includes receivables purchased from third parties. This category includes a "held to maturity" subcategory. Like the "loans granted and other receivables (non-trading portfolio)" category, this sub-category is measured at amortised cost (DAS 290.519).

A key argument for mandatory measurement at amortised cost for these categories is that, given its intention, the holder (in this case, the entity holding the financial asset) is not susceptible to changes in fair value over the life of the asset. So information about changes in value does not provide useful information for the entity holding these instruments. It is of course a different case if the instruments are part of a trading portfolio. Hence, this portfolio is consistently referred to in the table above.

Incidentally, DAS 290 says very little about the definition of "held to maturity" in this context, apart from the fact that this sub-category only applies if the entity firmly intends and is both contractually and economically able to hold such financial assets to maturity (DAS 290.410).

Financial liabilities due and payable immediately
The fair value of a financial liability with a demand feature is not less than the amount payable on demand (DAS 290.530).

No reliable fair value
If it is not possible to establish a reliable fair value for financial instruments by approximation methods, they are measured at cost (Article 10(3) BAW/DAS 290.505). If a reliable measurement method becomes available for a financial asset or financial liability for which no such method was previously available, that asset or liability is remeasured at fair value. This one-off revaluation is recognised directly in equity (DAS 290.531).

21.6.4.3 Determination of profit or loss for instruments measured at fair value through profit or loss versus through equity and (amortised) cost

When measuring at fair value directly through profit or loss, the value is adjusted in line with the change in fair value in that financial year. This method of recognition is therefore in line with the situation that this change in value (in principle not yet realised by a sale transaction) may also be considered as the return in that financial year.

On the other hand, in the event of fair value measurement where any change in fair value is recognised directly in a revaluation reserve and not as realised revaluation in profit and loss until realised through a sale transaction (which may be the case with purchased loans and bonds), the effective interest is presented as annual interest income in that year. This is also the case if measurement is made at amortised cost. In the case of both of these two principles, the following items are recognised directly in profit and loss (DAS 290.506):

- interest determined using the effective interest method;
- dividends on equity instruments to which entitlement has been established;
- gains and losses on the translation of monetary financial assets and financial liabilities denominated in foreign currencies;
- impairment charges (see below for a more detailed treatment);
- gains and losses on the derecognition of the financial instrument (e.g. upon sale, realisation or redemption of the instrument).

21.6.4.4 Reclassifications of financial instruments

The question is whether reclassification to a different category/sub-category is permitted during the life of a financial instrument. For example, management might now want to hold previously classified trading instruments until the end of their term. DAS 290 does not explicitly prohibit reclassification. The definitions of the categories/sub-categories could be interpreted to prevent reclassification. However, the Dutch Accounting Standards Board made it clear in DASB Statement 2008-4 that reclassification is allowed for justified reasons, indicating that the credit crisis of 2008 qualified as one such valid reason.

If financial instruments are reclassified, income or expenses may not be recognised at the time of reclassification (DAS 290.532). The following distinctions apply:

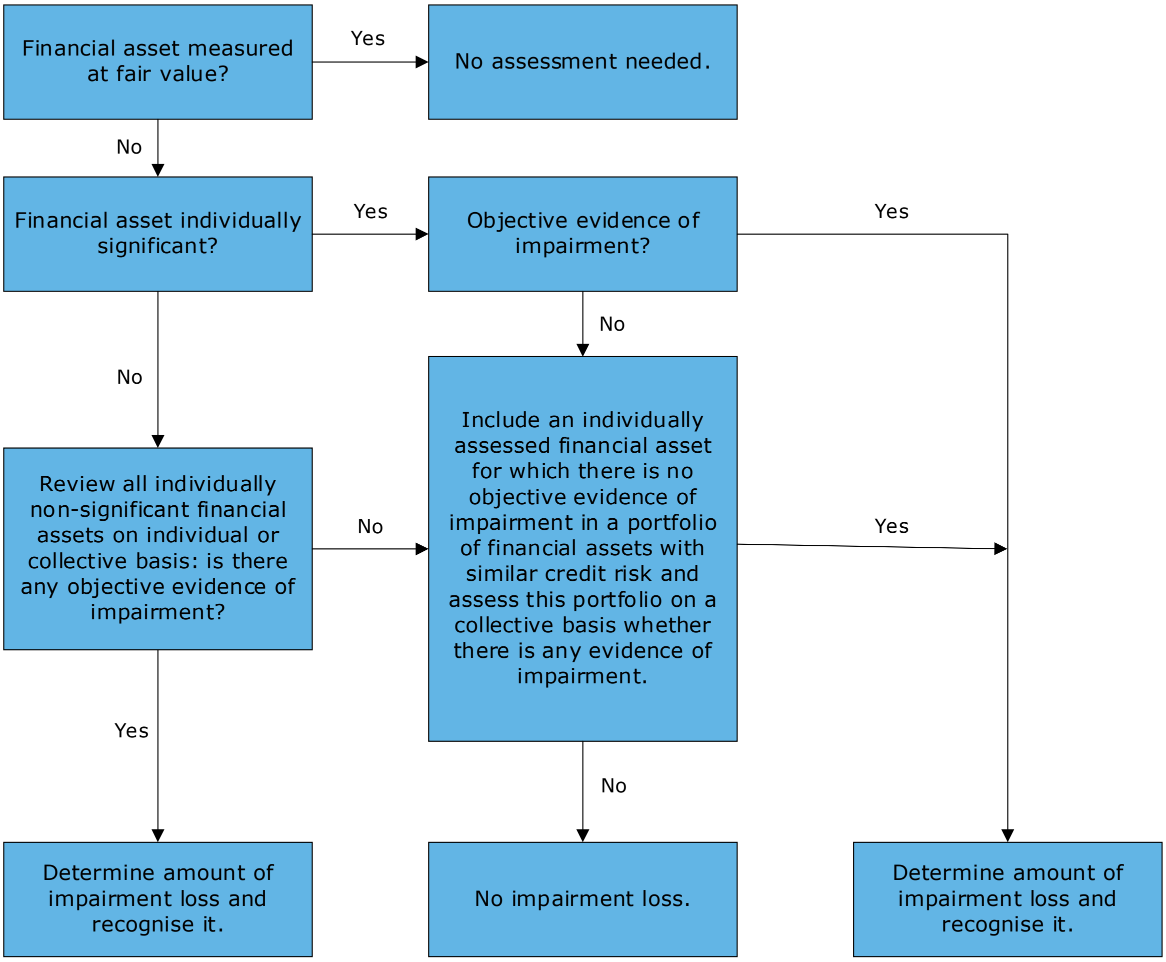
- reclassification from a cost category to a fair value category, where the revaluation is recognised directly in equity and not in the profit and loss account until the financial instrument is derecognised;
- reclassification from a fair value category to a cost category, where the fair value is recognised as initial cost (i.e. "deemed cost") at the time of the reclassification.

Given that a valid reason for reclassification must be present, it is important that the financial statements explain this reason. As the reclassifications may be related to changing market conditions or to a change in investment objective, in principle there is no need for a change in accounting policy with retrospective recognition. For example, if management decides to reclassify listed bonds to a cost category as a result of the disappearance of an active market and a change in investment policy, the reclassification should in principle be recognised at the time it is decided, and is not a change in accounting policy.

21.6.4.5 Impairment in the event of measurement at (amortised) cost

Preferred method
The preferred method is, at each reporting date, to review all individually significant financial assets measured at cost or amortised cost for any objective evidence of their impairment (DAS 290.533). For individually non-significant financial assets, this assessment should be done on an individual or collective basis. If there is no objective evidence of impairment of an individually assessed financial asset, the asset is included in a portfolio of financial assets with similar credit risk. A further collective assessment should then be made for this portfolio to determine whether there is any evidence of impairment (DAS 290.536).

The procedure for determining impairment losses is shown in the following diagram:



If there is evidence of impairment, the amount of the impairment loss should be determined and recognised in the profit and loss account (DAS 290.533).

If the basis for measuring fair value is applied directly through profit or loss, that means that all impairment losses are also directly charged to the profit and loss account. The considerations given above with regard to determining whether there is an indication of impairment (and determining the amount of it) then play no role, but are implicitly part of the principle used. Even if measured at fair value directly in equity (revaluation reserve), cumulatively negative unrealised remeasurements are charged directly to the profit and loss account (DAS 290.538).

Determining impairment requires determining the present value of the best possible estimate of future cash flows from the financial asset. If it is less than the carrying amount of the asset, it is impaired (DAS 290.537).

If the financial asset in question is measured at amortised cost, discounting of future cash flows should be calculated at the asset's effective interest rate as determined at initial recognition of the instrument. However, if the asset is an equity instrument measured at cost, discounting should be done using the current cost of capital for a similar financial asset (DAS 290.537).

Examples of objective evidence of impairment of a financial asset or a portfolio's financial assets are (DAS 290.534):

- significant financial difficulties of the entity or debtor issuing the instrument;
- breach of contract, such as defaults on interest payments or repayments;
- a concession from the lender to the borrower on economic or legal grounds linked to financial difficulties of the borrower, which the lender would not otherwise consider;
- likelihood of bankruptcy or financial restructuring of the borrower;
- the loss of an active market for that financial asset due to financial difficulties; or
- information indicating that there has been a determinable reduction in expected future cash flows from a portfolio of financial assets since their initial on-balance-sheet measurement, which reduction has not yet been observed for the individual financial assets in that portfolio, such as:
    - adverse changes in the payment status of borrowers in the portfolio (for example, an increased number of deferred payments or credit card debtors who have reached their credit limit and are paying the minimum monthly amount); or
    - national or local economic conditions closely related to the default on assets in the portfolio (e.g. an increase in unemployment in the geographical area of the borrowers, a fall in property prices if mortgages are held in the relevant area, or adverse changes in sectoral conditions affecting the borrowers in the portfolio).

The following examples need not in themselves constitute objective evidence of impairment, but could do so in conjunction with other evidence (DAS 290.535):

- the loss of an active market due to the other party's financial instruments no longer being traded on a stock exchange;
- a downgrade in the other party's creditworthiness (this is not in itself an indication of impairment, but may be an indication of impairment in conjunction with other available information);
- a decline in fair value of a financial asset below its (amortised) cost (this is not necessarily evidence of impairment; an example is a decline in the fair value of an investment in a debt instrument resulting from an increase in the risk-free interest rate).

Simplified alternative
An acceptable alternative to the preferred method described above for determining impairment and uncollectibility of financial assets measured at (amortised) cost is to systematically use the principle of "lower of cost and fair value". In that case, an impairment should be recognised if the fair value is less than the (amortised) cost (DAS 290.537a). If and to the extent that this fair value increases in a subsequent period, previously recognised impairment losses should be reversed up to the amount of the (amortised) cost that would have been determined if no impairment had occurred.

This simplified alternative may be chosen for each individual sub-category of financial assets. It goes without saying that this choice must then be applied consistently within each sub-category (DAS 290.537b).

Reversal of an impairment
If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor’s credit rating), that impairment of the financial asset is reversed (DAS 290.537).

The reversal of the impairment may not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in the profit and loss account for the period (DAS 290.537).

Application of the IFRS "expected credit loss model"
Alternatively, IFRS 9, applicable under IFRS, may be applied in the financial statements for the impairment and uncollectibility of:

- purchased loans and bonds (not included in the trading portfolio);

- loans granted and other receivables, including lease receivables and debit balances under construction contracts or contracts for the sale of goods or provision of services; and
- contracts for financial guarantees and loan commitments

instead of the provisions of DAS 290.533 to 540. This alternative involves determining impairment and uncollectibility of the listed instruments according to IFRS 9's "expected credit loss model" instead of DAS 290's 'incurred credit loss model'. The disclosures on impairments described in IFRS 7 Financial Instruments Disclosures are then also required (DAS 290.101).

A transition to IFRS 9's "expected credit loss model" represents a change in accounting policy. This must be recognised in accordance with DAS 140 Changes in accounting policies (see chapter 3); the comparative figures do not, however, need to be adjusted (DAS 290.1017).

21.6.4.6 Recognition of an amendment to contractual terms when measuring at amortised cost

Paragraph 21.5.2 discussed the derecognition of a financial instrument from the balance sheet, with reference to the general provisions on derecognition of assets and liabilities (DAS 115.1). It is also possible that contractual terms are changed *without* resulting in a significant change in economic reality. In that case, a financial instrument continues to be recognised on the balance sheet (DAS 115.109). The question is then how to recognise changes in contractual terms if the instrument is measured at amortised cost. The Dutch Accounting Standards Board has now developed standards that apply to reporting periods beginning on or after 1 January 2024 (DAS 290.523b). Earlier application is recommended. If, as a result of the amended contractual terms, the contractual cash flows are modified *without* resulting in any significant change in economic reality, the following recognition options are available:

a. recognising the effect of the modified contractual cash flows directly in profit and loss without adjusting the effective interest rate; or
b. recognising the effect of the modified contractual cash flows over the remaining expected life of the financial instrument in profit or loss by adjusting the effective interest rate.

An entity must consider all the facts and circumstances when making this choice. We are of the opinion that the choice of a method of recognition should be consistently applied by the entity on the basis of the general requirement with regard to consistency (Article 2:384(6) NCC).

The Dutch Accounting Standards Board makes it clear that these recognition methods allow entities to choose a method that does justice to the specific facts and circumstances. For example, a subsidiary of a parent entity that prepares its financial statements under IFRS may choose to apply recognition method a. because this is what the IFRS prescribes and the subsidiary's financial statements are included in the parent entity's consolidated financial statements. The Dutch Accounting Standards Board has indicated that it does not wish to prohibit the recognition method prescribed by the IFRS (recognising the effect of modified contractual cash flows directly in profit or loss) or to prescribe it as the only recognition method. The Board considers that the application of the other recognition method (see above under b.), depending on the circumstances, may also meet generally accepted standards for providing a true and fair view.

Using recognition method a., the effect of the modification is determined by recalculating the amortised cost of the financial instrument as the present value of the modified contractual cash flows discounted at the financial instrument's *original* effective interest rate. The conceptual rationale for this is that the instrument is measured using a historical cost method and remains on the balance sheet. Any difference with the amortised cost of the financial instrument immediately prior to the modification is then recognised directly in profit or loss. This treatment is consistent with the treatment prescribed by the IFRS.

Using recognition method b., a new effective interest rate is calculated based on the modified contractual cash flows. The new effective interest rate is the rate that discounts the newly agreed contractual cash flows over the remaining expected life of the financial instrument at the amortised cost of the financial instrument immediately prior to the modification. Consequently, the amendment to the terms will not immediately affect profit or loss. The conceptual rationale for this finds its justification in the fact that the amortised cost of the instrument remaining on the balance sheet is taken as the starting point at the time of the amendment to the contractual terms. As a result, any gain or loss resulting from the contractual amendment will be accrued over the remaining contractual life of the instrument. This situation partly corresponds to a floating rate instrument where no interim profit or loss is recognised at the time of the interest rate revision either (e.g. as a result of an adjusted EURIBOR rate). The adjusted interest rate over the next interest period (up to the next interest rate review) is the effective interest rate and is the basis for recognition in the profit and loss account. See also the explanation of the amortised cost under the definitions in paragraph 21.2.

Example: Recognition of an amendment to the contractual terms of a loan that does not significantly change the economic reality

Company A took out a five-year loan on 1 January of year 1 with a principal of 100,000 and an annual interest rate of 5%. The transaction costs are 2,000. A initially measures the loan at 98,000 (= 100,000 - 2,000). The loan cost of 98,000 will increase (amortised) to 100,000 over the life of the loan. A calculates the effective interest rate of the loan as follows:

5,000/(1+r)^1 + … + 5,000/(1+r)^5 + 100,000/(1+r)^5 = 98,000

This results in an effective interest rate of 5.468%.

Movements in the amortised cost of the loan over its entire term are as follows:

	Amortised cost (1/1)	Interest expense	Cash flow	Amortised cost (31/12)
Year 1	98,000	5,359	5,000	98,359
Year 2	98,359	5,378	5,000	98,737
Year 3	98,737	5,399	5,000	99,136
Year 4	99,136	5,421	5,000	99,557
Year 5	99,557	5,443	105,000	0

On 31 December of year 3, A agrees an amendment to the contractual terms of the loan with the bank, adjusting the annual interest rate for the remaining two years (4% instead of 5%). There could be various causes for this, such A being in financial difficulties and/or its desire to align the annual interest rate more closely to the then prevailing market rate.

A assesses whether this amendment significantly changes in the economic reality of this loan (in accordance with DAS 115.109). A concludes that it does not.

Based on the specific facts and circumstances of the case, A chooses a recognition method for the annual interest rate adjustment. The following recognition methods are available under DAS 290.523b:

a. recognising the effect of the adjustment directly in profit and loss; or
b. recognising the effect of the adjustment over the remaining life of the financial instrument in profit and loss by adjusting the effective interest rate.

Using recognition method a., the effect of the adjustment is determined by recalculating the amortised cost of the loan as the present value of the modified contractual cash flows discounted at the loan's original effective interest rate of 5.468%. The difference with the amortised cost immediately prior to the adjustment is recognised as profit or loss at the time of the adjustment. The recalculated amortised cost of the loan is 97,288 (= 4,000/(1,05468)^1 + 4,000/(1,05468)^2 + 100,000/(1,05468)^2). The adjustment to amortised cost of 1,848 (= 99,136 - 97,288) is recognised directly in profit and loss. The effective interest rate remains 5.468%.

The movement in the amortised cost of the loan over its entire term is then as follows:

	Amortised cost (1/1)	Interest expense	Cash flow	Amortised cost (31/12)
Year 1	98,000	5,359	5,000	98,359
Year 2	98,359	5,378	5,000	98,737
Year 3	98,737	5,399	5,000	
Year 3		-1,848		97,288
Year 4	97,288	5,320	4,000	98,608
Year 5	98,608	5,392	104,000	0

Using recognition method b., a new effective interest rate is calculated based on the modified contractual cash flows. From year 4 the new effective interest rate is then 4.461% instead of the original effective interest rate of 5.468% (4,000/(1+r)^1 + 4,000/(1+r)^2 + 100,000/(1+r)^2 = 99,136). Under this recognition method, the benefit to A of the agreed annual interest rate adjustment is recognised as profit over the remaining life of the loan by applying a lower effective interest rate. The movement in the amortised cost of the loan over its entire term is then as follows:

	Amortised cost (1/1)	Interest expense	Cash flow	Amortised cost (31/12)
Year 1	98,000	5,359	5,000	98,359
Year 2	98,359	5,378	5,000	98,737
Year 3	98,737	5,399	5,000	99,136
Year 4	99,136	4,422	4,000	99,558
Year 5	99,558	4,442	104,000	0

21.7 Hedge accounting

21.7.1 Introduction

Hedge accounting relates principally to financial instruments used to reduce, i.e. hedge, the financial risks of other assets or liabilities, mostly also financial instruments. Hedge accounting therefore identifies, on the one hand, the hedging instrument that serves to hedge a particular financial risk and, on the other hand, the hedged item, an item that exposes the entity to a particular financial risk. Applying the normal measurement rules to the hedged item and the hedging instrument may result in a mismatch in the allocation to profit or loss. This may be the result of applying different accounting principles to the hedged item and to the hedging instrument (measurement mismatch). Another cause may be differences in timing of recognition for the hedged item and the hedging instrument (mismatch in recognition). The latter is the case if a highly probable forecast transaction is not yet recognised on the balance sheet, while the hedging instrument does have to be recognised.

When applying hedge accounting, the normal rules for measurement and the recognition of the changes in value are adjusted so that the changes in value of the hedged item and in the hedging instrument are recognised simultaneously in the profit and loss account in order to correctly reflect the hedging of the risk in the reporting as well. How this adjustment to the normal rules takes place depends on the hedge accounting model applied (see below). Hedge accounting is thus a specific method of recognition, measurement and determination of profit or loss for situations where risks are hedged.

Example: Applying hedge accounting (1)

Company A takes out a loan for 10 million with a term of five years and a variable interest rate. To hedge against the risk of variable interest cash flows, A enters into an interest rate swap with a term of five years. The cost of the interest rate swap is zero. Under the interest rate swap, A receives a variable interest rate equal to EURIBOR on a notional amount of 10 million and pays a fixed interest rate of 5% on this notional amount. A measures derivatives at cost. On entering into the swap, the swap is measured at fair value on initial recognition, i.e. zero. Because EURIBOR has fallen, A has to pay, on balance, the difference between 5% and EURIBOR. At the reporting date of 31 December, the swap has a negative fair value of 150,000 for A.

If A does not apply hedge accounting, it must recognise a loss of 150,000 under DAS 290.541 and the derivative is measured at the negative fair value of 150,000. If hedge accounting is used in this instance, then no loss is recognised. As a result, the interest expense recognised in the profit and loss account in future periods consists of the variable interest rate on the loan and the settlement under the swap, which, on balance, is a fixed interest rate of 5%.

Hedge accounting can only be applied if and to the extent that the relevant risk is effectively hedged. Any ineffectiveness is recognised in the profit and loss account.

Example: Applying hedge accounting (2)

Company A from the previous example makes an early repayment on the loan, leaving a balance of 7.5 million. However, the interest rate swap has not changed and is still based on the notional amount of 10 million. This means that only 75% of the swap is still an effective hedge of the interest rate risk while 25% has become ineffective. Therefore, when applying hedge accounting, part of the loss of 150,000 is recognised and the derivative is measured on the balance sheet at a negative value equal to that loss. See paragraph 21.7.3 for determining and recognising ineffectiveness in cost hedge accounting.

Hedge accounting is thus only needed when there is a mismatch in the allocation to profit or loss. There is no mismatch when both the hedged item and the hedging instrument are measured at fair value through profit or loss. Changes in value then "automatically" match as a result of the accounting principles applied. Nor is there a mismatch, for example, in the case of a foreign currency loan hedged by a forward foreign exchange contract, where both instruments are recognised at fair value on the balance sheet with changes in value recognised in the profit and loss account. A change in the fair value of the forward foreign exchange contract also includes the effect of that change in the spot exchange rate (in addition to the effect of the change in the interest rate). As a result, changes in value are already matched in the profit and loss account and there is no need to use hedge accounting.

In summary, hedge accounting addresses the following two mismatches:

Mismatch in measurement	Mismatch in recognition
The hedged item is not measured at fair value or the change in value is not recognised in the profit and loss account.	The hedged item is not yet recognised on the balance sheet.

The following paragraphs describe the different models of hedge accounting and the corresponding recognition methods. Detailed examples of the application of hedge accounting are included in the annex to this chapter.

Applying hedge accounting is optional. It is therefore not mandatory, even if there are mismatches in the allocation to profit or loss.

21.7.2 Models of hedge accounting

DAS 290 identifies four models of hedge accounting:

- fair value hedge accounting. This reporting method may be used when a hedging instrument is used to hedge the risk of a change in the fair value of a hedged item (mismatch in measurement);
- cash flow hedge accounting. This reporting method may be used when a hedging instrument hedges the risk of changes in future cash flows (mismatch in recognition);
- cost hedge accounting. This reporting method may be used if the hedging instrument is measured at cost and if it is used to hedge the risk of a change in the fair value of a hedged item or the risk of variability in future cash flows (mismatch in measurement or recognition); and
- hedging a net investment in a foreign operation. This reporting method may be used if the risk of a change in the value of a net investment in a foreign operation is hedged (mismatch in recognition).

Fair value hedge accounting and cash flow hedge accounting are models adopted from IFRS. However, the IFRS standards do not include the cost hedge accounting model, as they require all derivatives to be recognised at fair value on the balance sheet with changes in value recognised in profit or loss. However, Title 9 Book 2 NCC and DAS 290 do not require all derivatives to be measured at fair value on the balance sheet. Also if derivatives are measured at cost on the balance sheet, a mismatch may arise between the allocation to profit or loss of the underlying hedged item on the one hand and of the derivative (hedging instrument) on the other. Cost hedge accounting can prevent this mismatch.

Fair value hedge accounting is a hedge of the exposure to changes in the fair value of a recognised asset or liability, or of an unrecognised firm commitment, or of an identified part of either of these, that relate to a particular risk and will affect reported net profit (DAS 290.618).

Cash flow hedge accounting is a hedge of the exposure to variability in cash flows that (DAS 290.618):

- is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on floating rate debt) or a highly probable forecast transaction (such as the expected sale of goods in foreign currency); and
- could affect profit and loss.

The different models of hedge accounting are summarised in the following diagram:

Model	Risk	Applicable to	Conditions
Fair value hedge accounting	Changes in fair value	recognised asset or liability or unrecognised firm commitment (or part of either of these)	Hedging instrument measured at fair value
Cash flow hedge accounting	Potential variability in cash flows	Cash flow risk associated with a recognised asset or liability or a highly probable forecast transaction	Hedging instrument measured at fair value
Cost hedge accounting	Changes in fair value or potential variability in cash flows	See above, under fair value hedge accounting and cash flow hedge accounting	Hedging instrument (and hedged item) measured at cost or hedging instrument is a foreign currency monetary item
Hedge of a net investment in a foreign operation	Currency risk of a net investment in a foreign operation	Loans hedging the currency risk of a foreign operation	Participating interest consolidated or measured at net asset value

It should be remembered that either fair value hedge accounting or cash flow hedge accounting may be used for certain financial items and risks. In addition, under DAS 290, cost hedge accounting may be applied whenever the hedging instrument is measured at cost. The following table lists various hedged risks and the models of hedge accounting that may be used for them:

Fixed rate financial assets and liabilities		Variable rate financial assets and liabilities	
Examples: • fixed rate loan or receivable • fixed rate listed securities • fixed rate liability		Examples: • floating rate loan or receivable • floating rate listed securities • floating rate liabilities	
Risk	**Hedge accounting**	**Risk**	**Hedge accounting**
Fair value risk (market risk)	Fair value hedge accounting	Fair value risk	Fair value hedge accounting
Interest rate risk	Fair value hedge accounting	Interest rate risk	Fair value hedge accounting * or cash flow hedge accounting
Credit risk	Fair value hedge or cash flow hedge accounting **	Credit risk	Fair value hedge or cash flow hedge accounting
Currency risk	Fair value hedge or cash flow hedge accounting	Currency risk	Fair value hedge or cash flow hedge accounting
Early repayment risk	Fair value hedge accounting	Early repayment risk	Fair value hedge accounting

Firm commitment to buy or sell financial instruments		Future purchase or sale of financial instruments	
Examples: • purchase contract concluded on fixed rate receivables • fixed rate loan contract concluded		Examples: • future purchase of fixed rate loans • grants of future loans granted	
Risk	**Hedge accounting**	**Risk**	**Hedge accounting**
Fair value risk	Fair value hedge accounting	Fair value risk	Cash flow hedge accounting
Interest rate risk	Fair value hedge accounting	Interest rate risk	Cash flow hedge accounting
Credit risk	Fair value hedge accounting	Credit risk	Cash flow hedge accounting
Currency risk	Fair value hedge or cash flow hedge accounting***	Currency risk	Cash flow hedge accounting

Firm commitment to buy or sell non-financial assets		Forecast purchases or sales of non-financial assets	
Examples: • contracts concluded for the sale of goods • contracts concluded for the purchase of goods		Examples: • probable forecast of sale of goods • probable forecast of purchase of goods	
Risk	**Hedge accounting**	**Risk**	**Hedge accounting**
Fair value risk	Fair value hedge accounting	Fair value risk	Cash flow hedge accounting
Currency risk	Fair value hedge or cash flow hedge accounting	Currency risk	Cash flow hedge accounting

Other assets	
Examples: • shares	
Risk	**Hedge accounting**
Fair value risk	Fair value hedge accounting
Currency risk	Fair value hedge or cash flow hedge accounting

* Fair value hedge accounting is generally possible for a fair value risk (market risk) of fixed rate assets and fixed rate liabilities with variable pricing dates.
** Cash flow hedge accounting is only appropriate for instruments with variable interest rate spreads depending on credit risk.
*** Firm commitments actually entail a fair value risk but, under both IFRS 9 and DAS 290, either fair value hedge accounting or cash flow hedge accounting may be applied to recognise the foreign exchange risk of a firm commitment.

21.7.3 Applying hedge accounting

Hedging documentation
Two options are available if an entity wishes to apply hedge accounting:

- applying hedge accounting based on generic documentation; or
- applying hedge accounting based on documentation per individual hedge relationship.

If an entity has chosen to apply hedge accounting on the basis of generic documentation, it needs to recognise certain hedged risks consistently (over time and by type of hedge relationship) according to the rules of hedge accounting, thereby departing from the general rules for recognition, measurement and determination of profit or loss (DAS 290.614). The entity's decision to apply hedge accounting for a particular hedge relationship is clear from the generic documentation. Applying hedge accounting based on generic documentation is subject to the following conditions (DAS 290.614):

- the entity describes its overall hedging strategy, documenting how its hedge relationships are aligned with its risk management objectives and its expectation regarding the effectiveness of these hedge relationships (i.e. the ability to offset changes in fair values or cash flows attributable to the hedged risk);
- the entity describes the hedging instruments and hedged items involved in the type of hedge relationship that meet the conditions for applying hedge accounting;
- ineffectiveness is recognised in the profit and loss account.

Example: Generic documentation of the hedge of a currency risk through forward foreign exchange contracts

A is an exporting company and sells its products across much of Europe. Part of its revenue is generated in the UK. These deliveries are invoiced in pounds (GBP) with a payment term of one month. On average, orders are placed one to two months before delivery. A's policy is to hedge the resulting currency risk through forward foreign exchange contracts when the orders are placed. A documents the foreign foreign exchange contracts entered into for this purpose in its records. The fair value (and cost) of the forward foreign exchange contracts at the time of closing is zero. Transaction costs for entering into forward foreign exchange contracts are considered negligible and are charged directly to the profit and loss account when the contract is concluded. Forward foreign exchange contracts are intended to hedge the risk of variability in cash flows receivable. The size and term of the forward foreign exchange contracts correspond to the size and expected payment terms of the concluded sales orders. Therefore, the forward foreign exchange contracts entered into are classified as highly effective (which in any case will also have to be assessed at every reporting date).

In that case, the generic hedging documentation may provide the following:

General hedging strategy

The strategy is to fully hedge the currency risk on closed sales orders in GBP. forward foreign exchange contracts are therefore concluded under which GBP is sold in exchange for euros at a fixed exchange rate.

Risk management objective

The objective is not to be exposed to the risk of variability in cash flows receivable from GBP sales. Given these objectives, every period, sales orders closed in GBP are hedged through forward foreign exchange contracts.

Type of hedge relationship

Cash flow hedging: hedge of the risk of variability in cash flows receivable.

Hedge accounting model applied

Cost hedge accounting.

Nature of the hedged risk

The risk of variability in cash flows receivable (currency risk).

Expected effectiveness

The size and term of the forward foreign exchange contracts correspond to the size and expected payment terms of the closed sell orders. Consequently, the forward foreign exchange contracts entered into are classified as highly effective.

Identification of the hedged item

Sales orders closed in GBP are recorded for each period in the sales records, including the expected delivery date and payment term. Changes in size and/or expected delivery date and payment term (including cancellations) are also recorded. The sales records therefore always show, for each period, the expected GBP cash flow from sales orders that have been closed but not yet delivered. The accounts receivable records show the GBP cash flow expected for each period from delivered sales orders.

Identification of hedging instruments

The size and term of the forward foreign exchange contracts are determined in accordance with the size and expected payment terms of the concluded sales orders. The following details of the forward foreign exchange contracts concluded per period are recorded in the records:

- date of conclusion;
- counterparty and contract number;
- size in GBP;
- forward rate;
- size in euro;
- date expiry.

Test of effectiveness

The hedge effectiveness will be assessed at the end of each period by comparing the critical terms of the forward foreign exchange contracts with those of the hedged cash flows (current sales orders). As long as these terms of the forward foreign exchange contracts match those of the hedged cash flows, it may be assumed that there is no ineffectiveness in the hedge relationship. If these terms do not match, any ineffectiveness is determined by carrying out a quantitative ineffectiveness measurement.

Determination and recognition of ineffectiveness

Ineffectiveness is recognised in profit and loss solely if and to the extent that it is cumulatively a loss. Ineffectiveness is determined by carrying out a quantitative ineffectiveness measurement. Hypothetical derivatives are used for this. If cumulative ineffectiveness has decreased at a subsequent reporting date, a gain is recognised equal to that decrease. Changes in value due to interest rate changes are not taken into account.

Applying hedge accounting based on documentation for each individual hedge relationship provides an entity with more flexibility than generic documentation, as it allows hedge accounting to be decided upon (in advance) for each individual hedge relationship. A separate decision whether to apply hedge accounting can then be taken in every other instance, e.g. for each swap hedging interest rate risk. When applying hedge accounting on the basis of generic documentation, certain hedged risks must be recognised consistently (over time and by type of hedge relationship) according to the rules of hedge accounting. Hedge accounting must then be applied to, for example, all swaps that hedge interest rate risks. Although this provides the advantage of flexibility, it entails a greater administrative burden given the obligation to prepare documentation for each individual hedge relationship.

Applying hedge accounting based on documentation for each individual hedge relationship is subject to the following conditions (DAS 290.615):

- the entity documents how this individual hedge relationship is aligned with its risk management objectives and describes its hedging strategy, including its expectation regarding the effectiveness of the hedge relationship;
- the entity describes the hedging instrument and the hedged item involved in the individual hedge relationship that meet the conditions for applying hedge accounting; and
- ineffectiveness under the individual hedge relationship should be recognised in profit and loss.

Example: Documentation of each individual hedge relationship

A takes out a four-year floating rate loan of 100 million on 1 January of year 1. The floating rate on the loan is EURIBOR plus a 200 basis points markup. EURIBOR at the start of the loan is 5%. Interest on the loan is calculated on an annual basis and is revised annually on 31 December based on EURIBOR. The expected repayment of the loan is 50 million after two years and 50 million after four years. A has the contractual option to repay all or part of the loan early after two years, or to defer part of the repayments (up to 25 million) for four years.

When taking out the loan, A enters into two interest rate swaps on 1 January of year 1, each with a notional amount of 50 million, with the agreement that during the term of the swap contract, A will receive a fixed interest rate in exchange for paying interest at the EURIBOR rate. One contract runs for two years and the other for four years. The swaps are entered into when the loan commences, each with a fair value (and cost) of zero at that point.

These swaps are intended to hedge the risk of variability in cash flows payable. The swaps match the interest terms of the loan as well as the expected size and the maturity of the loan. Therefore, the swaps are classified as highly effective (which in any case will have to be assessed at every reporting date).

In that case, the hedging documentation for this individual hedge relationship may provide the following:

Risk management objective

The objective is to avoid being exposed to the risk of variability in interest cash flows payable. Based on these objectives, floating rate loans should be hedged by an interest rate swap.

Type of hedge relationship

Cash flow hedging: hedge of the risk of variability in cash flows payable.

Hedge accounting model applied

Cost hedge accounting from 1 January of year 1.

Nature of the hedged risk

The risk of variability in cash flows payable (interest rate risk).

Identification of the hedged item

Future interest payments on a four-year floating rate loan with a principal of 100 million:

- from 1 January of year 1 to 31 December of year 4, future interest payments on the first half of the principal are hedged (future interest payments on first part of the loan = 50 million);
- from 1 January of year 1 to 31 December of year 2, future interest payments on the other half of the principal are hedged (future interest payments on second loan part = 50 million).

The floating rate on the loan is EURIBOR plus a 200 basis points markup.

Identification of the hedging instrument

Two interest rate swaps have been entered into, each with a notional amount of 50 million, with the agreement during the term of the swap contracts, A will receive a fixed interest rate in exchange for paying interest at the EURIBOR rate. The term of contract 1 is four years and that of contract 2 two years.

Test of effectiveness

The hedge effectiveness will be assessed at the end of each financial year by comparing the critical terms of the interest rate swaps with those of the loan. As long as these terms match, it may be assumed that there is no ineffectiveness in the hedge relationship. If these terms do not match, any ineffectiveness is determined by carrying out a quantitative ineffectiveness measurement.

Determination and recognition of ineffectiveness

Ineffectiveness is recognised in profit and loss solely if and to the extent that it is cumulatively a loss. Ineffectiveness is determined by carrying out a quantitative ineffectiveness measurement. A hypothetical derivative is used for this. If cumulative ineffectiveness has decreased at a subsequent reporting date, a gain is recognised equal to that decrease.

Qualifying hedged items
The following hedged items may be part of hedge accounting (DAS 290.611):

- an asset or homogeneous group of assets;
- a liability or homogeneous group of liabilities;
- a firm commitment or homogeneous group of firm commitments;
- a highly probable forecast transaction (or homogeneous group of such transactions);
- a net investment in a foreign operation; or
- component of the size, term to maturity or risk of items listed above.

A firm commitment is one in which there is agreement between the parties to exchange a specified quantity of economic resources at a specified price on a specified date or on specified dates in the future (DAS 290.423).

To qualify for hedge accounting, the hedged item must be able to affect the profit and loss account. One example of a hedged item which does not qualify for hedge accounting is the situation of an entity with the euro as its functional currency that swaps the currency risk of a loan in euros to USD. This loan cannot qualify as a hedged item for applying hedge accounting in relation to the currency risk as it does not entail any currency risk that could affect the profit and loss account. There is therefore no reason to make an exception to the normal rules for measurement and determination of profit or loss.

A component of the size, term to maturity or risk of the above items may qualify as a hedged item, provided that component can be separately identified and reliably measured and the hedge effectiveness can be determined. For example, the currency risk and interest rate risk can be separately designated for hedge accounting. Examples are (DAS 290.611):

- the interest rate risk of an interest bearing asset or interest bearing liability arising from the risk-free or benchmark interest rate (i.e. excluding the credit risk markup) of a hedged item; and
- the price risk associated with the standard price of a commodity established on a commodity futures exchange.

If similar assets or similar liabilities are aggregated and hedged as a group, the individual assets or individual liabilities in the group will share the risk exposure that is designated as being hedged. Furthermore, the change in fair value attributable to the hedged risk for each individual item in the group will be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items.

The effectiveness of the hedge must be assessed by comparing the change in the fair value or cash flow of (1) a hedging instrument (or group of similar hedging instruments) and (2) a hedged item (or group of similar hedged items). Comparing (1) a hedging instrument with (2) an overall net position - instead of comparing with a specific hedged position - does *not* satisfy the conditions for hedge accounting. For example an overall net position is the net of all fixed rate assets and fixed rate liabilities with similar maturities. However, almost the same effect that hedge accounting has on net income in this type of hedge relationship can be achieved by designating part of the underlying items as the hedged item.

Example: Qualifying hedged item

A bank has 100 in assets and 90 in liabilities with similar risks and terms to maturity. If the bank wants to hedge the net risk of 10, it can designate 10 of the assets as the hedged item. This is allowed if the assets and liabilities in question are fixed rate instruments, in which case fair value hedge accounting applies, or if these assets and liabilities are floating rate instruments, in which case cash flow hedging applies.

An entity has a firm commitment to buy 100 in foreign currency and a firm commitment to sell 90 in the same foreign currency. The entity can hedge the balance of 10 by purchasing a derivative and designating it as a hedging instrument associated with 10 of the fixed purchase obligation of 100.

Qualifying hedging instruments
Solely the following may be designated as hedging instruments (DAS 290.605):

- all derivatives except (on balance) written options (as these do not mitigate risks);
- a financial asset or financial liability, other than a derivative, solely and exclusively when designated for hedging currency risks, as these items are remeasured to closing rate at each reporting date.

Solely instruments entered into with a third party may be designated as hedging instruments (DAS 290.608). For consolidated financial statements, for example, a consolidated operating company is not a third party. Hedge accounting may then only be applied if one of the consolidated companies has concluded a contract with a third party, e.g. an external bank. The fact is that contracts between consolidated companies are eliminated. However, for accounting purposes in the company-only financial statements, contracts between group companies may qualify for hedge accounting.

Hedge effectiveness
DAS 290 does not provide any specific requirements regarding minimum hedge effectiveness. It merely states that the ineffective part of the hedge has to be recognised in the profit and loss account. This is self-evident, because there is a mismatch in the allocation to the profit and loss account for the ineffective part which cannot be resolved by

applying hedge accounting. Nor does DAS 290 set strict rules on how to measure effectiveness, but gives examples of this (DAS 290.616):

- by comparing the change in fair value of the hedging instrument with that of the hedged item in a given period or since the beginning of the hedge relationship;
- by comparing the critical terms of a hedging instrument with those of a hedged item; or
- by performing regression analysis on the changes in the fair value of a hedging instrument and of the hedged item.

The provisions of DAS 290.616 apply to all hedge accounting models. Specifically as regards cost hedge accounting, DAS 290 includes additional provisions on how to determine the effectiveness of a cost hedge. See paragraph 21.7.4.3.

If, according to the documented strategy, a particular component of the change in value of the hedging instrument is excluded from assessment of hedge effectiveness, hedge accounting may not be applied to that excluded component. The "basic rules" for measurement and determination of profit or loss then apply to the excluded component. When measured at fair value, the revaluation, to the extent attributable to that excluded component, is recognised in profit and loss (DAS 290.628).

An example of excluding a particular component of the change in value is a hedge of the foreign exchange risk of a foreign currency firm commitment, where any change in value of the forward foreign exchange contract (hedging instrument) due to changes in forward interest rates is excluded from hedge accounting. The fact is that any changes in the fair value of a forward foreign exchange contract consist of the effect of the change in the spot exchange rate and the effect of interest rate changes on the forward points. The excluded portion is the difference between forward price and period-end price (forward points). Therefore, in this example, forward points due to interest rate differentials are excluded from hedge accounting. The changes in value in the forward points of the forward foreign exchange contract are then recognised in profit and loss (because hedge accounting is not applied to this portion). Hedge accounting is applied to the change in the value of the forward foreign exchange contract due to a change in the current exchange rate. Therefore, in forward transactions, forward points may be excluded from hedge accounting.

In option contracts, a distinction can be made between the option's intrinsic value and its time value. The option's intrinsic value may be designated as a hedging instrument while excluding the change in time value. The difference between an option's exercise price and its current price is the option's intrinsic value. The option's time value is based on the expected movement of the price. When using options as hedging instruments, the option's time value may be excluded from hedge accounting. An option's time value is what is left of the option's value after deducting its intrinsic value.

21.7.4 Methods of recognition for the different types of hedge accounting

21.7.4.1 Fair value hedge accounting

Fair value hedge accounting may be applied to reflect the hedging of fair value changes in the financial statements. Applying fair value hedge accounting resolves the mismatch in measurement.

In fair value hedge accounting, the hedging instrument is recognised at fair value on the balance sheet (DAS 290.618). Changes in the fair value of the hedging instrument and changes in the fair value of the hedged item, to the extent attributable to the hedged risk, are recognised immediately in profit or loss. If the hedge is highly effective, the effect on profit or loss of the change in value of the hedged item and the hedging instrument is, on balance, nil or small. If the measurement of the hedged item is recognised at (amortised) cost, this carrying amount should be adjusted only for the revaluation attributable to the hedged risk (DAS 290.619). Therefore, the hedged item is measured not at fair value but still at amortised cost, with the effective portion of the hedge being adjusted.

The application of fair value hedge accounting when measuring the hedged item at fair value where changes in value of the hedged position are recognised directly in equity according to the basic rules, can be illustrated as follows (assuming a positive change in the value of the hedged item):

Balance sheet	D	C
Hedged item	Fair value (ΔV)	
Hedging instrument (e.g. derivative)		Fair value (ΔV)
Equity		ΔV for ineffective portion
Profit and loss account	**D**	**C**
Change in value of hedged item		ΔV for effective portion
Change in value of hedging instrument	ΔV	

ΔV represents the change in value of the financial instrument in question. As the underlying position - recognised on the balance sheet - is measured at fair value with measurement differences recognised directly in equity until realisation, the ΔV is split into the effective portion of the hedge relating to the hedged risk on the one hand and the ineffective portion on the other. ΔV therefore represents the revaluation that would have been recognised directly in equity without hedge accounting. Due to the fact that fair value hedge accounting is applied, we examine what part of the revaluation is attributable to the hedged risk. This therefore refers to the effective portion. ΔV relating to this effective portion of the hedge is then recognised in the profit and loss account so that a proper match is achieved with the change in value of the derivative which is also recognised in the profit and loss account. ΔV relating to the ineffective portion is recognised directly in equity according to the normal rules of the applicable basic rules. It could also be argued that this is the 'remaining' part of the revaluation of the hedged item.

The recognition of fair value hedge accounting when the hedged item is measured at amortised cost can be illustrated as follows (assuming a positive change in the value of the hedged item):

Balance sheet	D	C
Hedged item		Amortised cost plus ΔV
Hedging instrument (e.g. derivative)	Fair value (ΔV)	
Profit and loss account	**D**	**C**
Change in value of hedged item		ΔV
Change in value of hedging instrument	ΔV	

The application of fair value hedge accounting when designating an off-balance sheet firm commitment as a hedged item can be illustrated as follows (assuming a negative change in the value of the hedged item for the company):

Balance sheet	D	C
Hedged item (change in fair value of an unrecognised firm commitment)		ΔV (risk)
Hedging instrument (e.g. derivative or currency portion of a financial asset/liability)	Fair value (ΔV)	
Profit and loss account	**D**	**C**
Change in value of hedged item	ΔV (risk)	
Change in value of hedging instrument		ΔV

When an unrecognised firm commitment is designated as a hedged item, the cumulative change in fair value since the application of hedge accounting, to the extent attributable to the hedged risk of the firm commitment, is recognised as an asset or liability, with a corresponding gain or loss being recognised in profit and loss. Changes in the fair value of the hedging instrument are also recognised in profit and loss (DAS 290.623). The asset or liability arising from the revaluation of the hedged firm commitment is recognised as part of the initial measurement of the asset or liability recognised on the balance sheet through the settlement of the firm commitment (DAS 290.624).

21.7.4.2 Cash flow hedge accounting

Cash flow hedge accounting may be applied to reflect the hedging of cash flow variability in the financial statements. Applying cash flow hedge accounting resolves the accounting mismatch that otherwise arises due to the fact that, unlike the hedging instrument, the hedged item is not yet recognised on the balance sheet (DAS 290.617).

In cash flow hedge accounting, the hedging instrument is recognised at fair value on the balance sheet (DAS 290.618). Changes in the fair value of the hedging instrument are recognised in equity (revaluation reserve) for the effective portion during the term of the hedge. Changes in value relating to the ineffective portion are recognised in the profit and loss account. The cash flow hedge accounting model can be illustrated as follows (assuming a positive change in the value of the hedging instrument):

Balance sheet	D	C
Equity		ΔV for effective portion
Hedging instrument (e.g. derivative)	Fair value (ΔV)	
Profit and loss account	**D**	**C**
Change in value of hedging instrument		ΔV for ineffective portion

The ineffective part of the hedge is recognised in the profit and loss account. To enable the ineffective portion of the hedge to be recognised in the profit and loss account in the appropriate period (and on time), DAS 290.625 defines a maximum that may be recognised directly in equity. This is the lower absolute amount of the following two changes in value:

- the cumulative change in fair value of the hedging instrument since that instrument was designated for the application of cash flow hedge accounting; and
- the cumulative fair change in the value of future hedged cash flows to the extent attributable to the hedged risk.

The question is then how the amount recognised in equity is "released" again when the hedged transaction occurs. This recognition method differs depending on whether the future transaction results in a financial instrument or a non-financial instrument.

- If the future hedged transaction results in the recognition of a financial asset or financial liability, the changes in value deferred directly in equity are recognised in profit or loss in the same period(s) in which the asset acquired or liability assumed affects profit or loss (e.g. in the period in which interest gains and losses are recognised). If the expectation is that a negative change in value (or part of it) recognised directly in equity can no longer be offset, it should be charged directly to the profit and loss account (DAS 290.630).
- If the future transaction results in the recognition of a non-financial asset or a non-financial liability (e.g. the capitalisation of inventories or an item of property, plant and equipment), or if a forecast transaction becomes a firm commitment (e.g. the investment obligation is contractually agreed), the amounts recognised directly in equity should be recognised in the initial cost or other carrying amount of the asset or liability that arises when the hedged future transaction occurs. This recognition method is also called a basis adjustment because the initial carrying amount of the asset or liability is adjusted (DAS 290.631).

However, if the entity expects that a loss recognised directly in equity (or part of it) cannot be offset by an opposite gain from the hedged item in one or more future periods, the entity must transfer to the profit and loss account the portion of the profit or loss recognised in equity that is not expected to be offset (DAS 290.631).

For the recognition of changes in value of hedging instruments in equity (revaluation reserve) as a result of applying cash flow hedge accounting, please refer to paragraph 14.3.7.5.

21.7.4.3 Cost hedge accounting

Under NL GAAP, certain derivatives may be measured at cost. This is an important difference from IFRS. Under IFRS, all derivatives are measured at fair value. If derivatives are measured at cost on the balance sheet, a mismatch could occur. This mismatch occurs between the allocation of profits or losses to the profit and loss account of the underlying hedged item on the one hand and the derivative (the hedging instrument) on the other. The fact is that the changes in the derivative's value are not recognised when measured at cost, unless the contract is onerous. By applying cost hedge accounting, an entity can ensure that this mismatch does not occur.

In cost hedge accounting, both the hedging instrument and the hedged item are measured at cost. Thus, *in principle*, the model can only be applied if the hedging instrument (e.g. a derivative) is measured at cost. A number of derivatives, such as derivatives with listed shares as the underlying, must be measured at fair value through profit or loss according to the basic rules. *However*, if such a derivative is designated as hedging instrument in the context of cost hedge accounting, this basic rule will be *deviated from* and the derivative will be measured at cost. Cost hedge accounting can also be applied to derivatives with an underlying other than listed shares. Such derivatives can already also be measured at cost without applying cost hedge accounting. However, the problem is that if the fair value is lower than cost, a loss has to be recognised according to the basic rules (impairment and/or loss from an onerous contract). However, if such a derivative is part of an effective hedge relationship, cost hedge accounting may be applied. By designating this derivative for cost hedge accounting, it is permissible to depart from the basic rules and still measure it at cost if the fair value is less than cost. In that case, no loss is recognised (to the extent that the hedge relationship is effective of course).

If the hedged item is measured at fair value, the hedging instrument should also be measured at fair value and it is not possible to apply cost hedge accounting but fair value hedge accounting or cash flow hedge accounting has to be applied, as appropriate.

Recognition depends on whether or not the hedged item is recognised on the balance sheet and whether it has a foreign currency component. In the table below, we assume a hedged item on the balance sheet and assume derivatives are measured at cost and there is a positive change in the value of the hedged item. This means that there will be a negative change in value of the hedging instrument. We also assume that the hedge relationship is partially ineffective.

Balance sheet	**D**	**C**
Hedged item		Cost
Hedging instrument (e.g. derivative)	Cost relating to effective portion Cost taking into account loss on ineffective portion	
Profit and loss account	**D**	**C**
Change in value of hedging instrument	Loss on ineffective portion	

Measuring the hedging instrument at cost is only permissible for the effective portion of the hedge. Hedge accounting is not applied for the ineffective portion of the hedge. After all, the matching intended by hedge accounting may only be applied to the effective portion of the hedge.

Cost hedge accounting may also be applied if a future cash flow is hedged. The model is then as follows (assuming derivatives are measured at cost and there is a positive change in the value of the hedged item):

Balance sheet	**D**	**C**
Hedging instrument (e.g. derivative or foreign currency component of financial asset or liability)	Cost relating to effective portion Cost taking into account loss on ineffective portion	
Profit and loss account	**D**	**C**
Change in value of hedging instrument	Loss on ineffective portion	

As long as the hedged item has not yet been recognised on the balance sheet, the hedging instrument is not revalued. This is the case, for example, when hedging the currency risk in future sales or purchases of goods. The foreign currency component of the forward contract that serves as a hedge is not measured on the balance sheet until those sales or purchases of goods actually take place.

Determining and measuring ineffectiveness in cost hedge accounting
The effectiveness of a hedge relationship is the extent to which changes in the value of the hedging instrument offset changes in the value of the hedged item. Ineffectiveness is the extent to which these two changes in value do not offset each other.

DAS 290 "Financial instruments" specifically states that, as regards cost hedge accounting, a company must perform the following steps at every reporting date (DAS 290.634):

1. comparison of the critical terms of the hedging instrument and the hedged item;
2. a quantitative ineffectiveness measurement must be carried out if step 1 shows that the critical terms do not match.

Re 1. Comparison of critical terms
The critical terms of a hedge relationship are the terms that determine the extent to which the risk in question is actually hedged or mitigated. It is therefore these terms that determine the degree of effectiveness. They include the size, term to maturity, the hedged risk and the method of settling the hedging instrument and of the hedged item. If

the critical terms of the hedging instrument and the hedged item match, then the hedge relationship can be classified as fully effective. There is then no ineffectiveness and a quantitative ineffectiveness measurement need not be carried out.

Example: Fully effective hedge relationship (taken from DAS 290.634) (1)

An interest rate swap where notional and principal amounts, term, repricing dates, dates of interest and principal receipts and payments, and basis for measuring interest rates are the same for the hedging instrument and the hedged item.

Example: Fully effective hedge relationship (taken from DAS 290.634) (2)

A forward foreign exchange contract where the settlement date, currency and size of the hedged payment obligation match (at least) the settlement date, currency and notional size of the forward contract.

Re 2. Quantitative ineffectiveness measurement
If the critical terms of the hedging instrument and the hedged item do not match, this is an indication that the hedge relationship contains an ineffective portion. In that case, the quantitative ineffectiveness has to be measured.

Example: Ineffective hedge relationship (1)

A takes out a loan of 10 million in January of year 1 with a variable interest rate based on EURIBOR and a term of five years. To hedge against the risk of variable cash flows, A also enters into an interest rate swap (EURIBOR receivable, 5% payable) with a term to maturity of five years. A makes an early repayment on the loan in December of year 1, thus reducing it to 7.5 million. However, the interest rate swap has not changed and is still based on the notional amount of 10 million. A applies cost hedge accounting. At the end of year 1, EURIBOR has decreased, meaning that the interest rate swap has a negative fair value of 150,000 for A.

Because the critical terms no longer match at year-end 1 (the principal amount of the hedged item is lower than the principal amount of the interest rate swap), there is ineffectiveness. The quantitative ineffectiveness therefore has to be measured. This can be done in this example simply by comparing the principal amount of the hedged item with the principal amount of the interest rate swap. The fact is that 25% of the interest rate swap has become ineffective. As a result, the interest rate swap is measured on the balance sheet at year-end year 1 at a negative value of 37,500 (= 25% of 150,000). The prerequisite for this "simplified" measurement of ineffectiveness is that all other critical terms match.

Example: Ineffective hedge relationship (2)

A takes out a loan of 5 million in January of year 1 with a variable interest rate based on EURIBOR and a term of 3 years. To hedge against the risk of variable cash flows, A also enters into an interest rate swap (EURIBOR receivable, 4% payable) with a term of 3 years. A makes an early repayment on the loan in December of year 1, thus reducing it to 4.5 million. A applies cost hedge accounting.

A holds discussions with the bank at the time of repayment and is also able to reduce the principal amount of the interest rate swap to 4.5 million in December of year 1. The other terms still match. After the adjustment, the critical terms of the interest rate swap match those of the (reduced) loan. Therefore, the adjusted interest rate swap is fully effective. However, the bank charges a fee of 15,000 to adjust the principal amount of the swap. As all other terms of the interest rate swap still match, the fee of 15,000 in fact offsets the ineffectiveness of the original interest rate swap. This amount is therefore recognised as an expense in the profit and loss account for year 1 at the point that the ineffectiveness occurs (date of early repayment).

According to the Dutch Accounting Standards Board, the most appropriate interpretation of the quantitative ineffectiveness measurement is to compare (1) the cumulative change in the fair value of the hedging instrument with (2) the cumulative change in the fair value of the hedged item since the designation of the hedge relationship (DAS 290.634).

There is usually information available about the fair value of the hedging instrument (e.g. an interest rate swap) and therefore also about its cumulative change. What is more difficult is to determine the cumulative change in the fair value of the hedged item (e.g. a loan).

In practice, the cumulative change in the fair value of the hedged item is usually calculated using a "hypothetical derivative'". The hypothetical derivative is then a derivative whose critical terms fully match the critical terms of the hedged item. As a result, the cash flows of the hypothetical derivative mirror the cash flows of the hedged item. The change in value of the hypothetical derivative is deemed to reflect the change in value of the hedged item. The fair value of the hypothetical derivative at the start of the hedge relationship must be determined at arm's length, based on current market parameters. If the hedged item changes, the hypothetical derivative should also be changed at that time. The adjusted hypothetical derivative should again mirror the cash flows of the adjusted hedged item and should again be determined at arm's length at the start of the hedge relationship (as if a new derivative is being bought in the market). This is illustrated in the example below.

Example: Hypothetical derivative (taken from DAS 290)

On 1 July of year 1, A expects with a very high degree of probability that it will raise a fixed rate loan of 100 million in six months' time (on 1 January of year 2). The term of this loan will be five years. Interest on the loan will be payable every six months.

A recognises the risk that interest rates may rise over the next six months. A decides to hedge that risk by entering into a forward starting interest rate swap on 1 July of year 1 (starting date 1 January of year 2, ending on 31 December of year 6, 6-month EURIBOR receivable, 5% payable and a face value of 100 million).

At 1 July of year 1, the cost (fair value) of this forward starting interest rate swap is zero. A decides to apply cost hedge accounting. The hedging documentation that A prepares on 1 July of year 1 for this hedge relationship will include the requisite information. A includes the following in the hedging documentation:

- hedge effectiveness is assessed by comparing the critical terms of the forward starting interest rate swap with the hedged cash flows. As long as these terms of the forward starting interest rate swap match those of the hedged cash flows, it may be assumed that there is no ineffectiveness in the hedge relationship;
- if these terms do not match, any ineffectiveness is determined by measuring quantitative ineffectiveness. A hypothetical derivative is used for this.

On 1 July of year 1, the forward starting interest rate swap is recognised at cost (zero). When A enters into the forward starting interest rate swap, the critical terms of the swap match those of the hedged item. No measurement of quantitative effectiveness is required. Consequently, A does not recognise any ineffectiveness. In this situation, the actual derivative entered into is the same as the hypothetical derivative. Ineffectiveness is therefore zero by definition.

On 31 December of year 1, A alters its estimate of when the loan will be raised. It now expects to raise the loan one month later. A also expects to raise 95 million instead of the original 100 million. This creates two sources of hedge ineffectiveness. Given that the critical terms of the forward starting interest rate swap and the hedged cash flows no longer match, A needs to measure quantitative effectiveness. In line with the information set out in the hedging documentation, A makes this measurement by comparing the fair value of the forward starting interest rate swap with the fair value of the hypothetical derivative. However, A changes the hypothetical derivative as a result of the changes in the hedged item. The adjusted hypothetical derivative is a derivative that would have had a fair value of zero at 1 July of year 1, the terms of which are:

- interest payments on the derivative start on 1 February of year 2 and end on 31 January of year 7 (instead of on 1 January of year 2 and ending on 31 December of year 6);
- receipt of 6-month EURIBOR (unchanged);
- payment of 5.1% fixed (rather than the 5% of the real derivative and the original hypothetical derivative; the change in the fixed interest rate of this hypothetical derivative is due to a different forward interest rate curve for the period from 1 February of year 2 to 31 January of year 7 than for the period from 1 January of year 2 to 31 December of year 6; the fact is that the fixed interest rate of the forward interest rate swap is determined by discounting the expected variable interest amounts based on the forward interest rate curve and equating them to the present value of the fixed interest amounts); and

- a face value of 95 million (instead of the original 100 million).

The fair value as at 31 December of year 1 of the derivative actually entered into (and therefore the change in value of the hedging instrument) is 800,000 negative. The fair value of the adjusted hypothetical derivative as at 31 December of year 1 is 780,000 negative. This therefore implies that the fair value of the hedged item is considered to have undergone a positive cumulative change in value of 780,000 during the second half of year 1. A therefore recognises ineffectiveness of 20,000, Specifically, it recognises it as a charge to the profit and loss account for year 1. A does not recognise anything on the balance sheet or the profit and loss account as regards the remaining negative value of the actually concluded derivative in the amount of 780,000. The fact is that this is offset by an unrecognised gain from the change in the hedged item. The journal entries are then as follows:

Hedge ineffectiveness (profit and loss account)	20,000	
Liability (balance sheet)		20,000

Recognition of ineffectiveness in cost hedge accounting
If cost hedge accounting is applied, the ineffectiveness must be recognised in the profit and loss account (DAS 290.614 and 615). However, this is only the case to the extent that changes in value of the hedging instrument are recognised in the profit and loss account even without the application of cost hedge accounting. Thus, if cost hedge accounting is applied, ineffectiveness is recognised in the profit and loss account only if and to the extent that it involves a loss on a cumulative basis. The fact is that cumulative gains in the event of measurement at cost are not recognised in the profit and loss account until the sale.

This means that if the hedging instrument undergoes a negative change in value relative to cost, the entity recognises the ineffectiveness in the profit and loss account to the extent that the cumulative negative fair value change in the hedging instrument is greater in absolute terms than the opposite fair value change in the hedged item.

If this cumulative ineffectiveness has decreased at a subsequent reporting date, a gain is recognised equal to that decrease in ineffectiveness. Because ineffectiveness is recognised only if and to the extent that it results in a loss on a cumulative basis at the reporting date, it does not result in a gain being recognised on a cumulative basis due to ineffectiveness.

Example: Recognition of ineffectiveness if cost hedge accounting is applied

Time	Fair value hedging instrument	Cumulative change in fair value of hedging instrument (a)	Fair value of hedged item	Cumulative change in fair value of hedged item (b)	Ineffectiveness (difference between (a) and (b)	Change in profit and loss
T = 0	0	N/A	1,000	N/A	N/A	0
T = 1	-100	-100	1,115	115	15	0
T = 2	-250	-250	1,245	245	-5	5
T = 3	-175	-175	1,173	173	-2	-3
T = 4	-100	-100	1,110	110	10	-2

The assumption is that the company applies cost hedge accounting. Up to T = 1, no ineffectiveness is recognised in the profit and loss account. The fact is that the difference between the cumulative change in the fair value of the hedging instrument and the cumulative change in the fair value of the hedged item results in a gain of 15. At T = 2, however, there is a cumulative loss. This cumulative loss of 5 is recognised as ineffectiveness in the profit and loss account. A liability of 5 is also included. At T = 3, the cumulative loss is 2.

As a result, a gain of 3 is recognised in the profit and loss account, after which the liability is 2. At T = 4, there is a cumulative gain of 10. This gain is only recognised for the portion previously recognised as ineffectiveness. This means that the liability is reduced to zero and a gain of 2 is recognised in the profit and loss account. The fact is that cumulative gains in the event of measurement at cost are not recognised in the profit and loss account until the sale.

Cost hedge accounting on a hedged currency position not yet recognised on the balance sheet
A company expects to receive a USD amount in three months due to an expected transaction. Nothing of this transaction can yet be recognised on the balance sheet. However, the company is already exposed to currency risk on

the amount it expects to receive. If the USD exchange rate falls, this will reduce the amount it receives in euro. The company can enter into a forward foreign exchange contract to hedge against this currency risk.

A forward foreign exchange contract is a contract to buy or sell foreign currency at a future time at an exchange rate (forward rate) and quantity agreed at the outset. The agreed exchange rate is made up of an exchange rate at the time of closing, the current exchange rate (spot rate) and a markup. The markup is based on the interest rate differential between the two currencies concerned. This difference is sometimes referred to as forward points, as they are mainly a consequence of interest rate differentials between, in this case, the eurozone and the United States. Adjustments in interest rate and inflation expectations lead to changes in the value of forward points. Changes in the current exchange rate affect the intrinsic value of the forward foreign exchange contract.

When cost hedge accounting is applied, the forward foreign exchange contract is measured at cost as long as the hedged item is not yet recognised on the balance sheet. The cost of the forward foreign exchange contract is zero at closing. The currency component of the forward foreign exchange contract that serves to hedge it is not yet recognised on the balance sheet when measured at cost until the transaction actually takes place. The consequence of this is that the forward points are not recognised either.

Cost hedge accounting on a hedged item concerning a foreign currency monetary item recognised on the balance sheet
A company may have a foreign currency receivable from a customer. This receivable is recognised on the balance sheet. Foreign exchange gains and losses on this receivable are recognised in the profit and loss account. The company might have entered into a forward foreign exchange contract to hedge the currency risk on this receivable. The forward foreign exchange contract is measured at cost if cost hedge accounting is applied. However, the currency element in the forward foreign exchange contract is measured separately at the current exchange rate at the reporting date (DAS 290.633). The currency components of both the forward foreign exchange contract and the hedged item are then recognised at the current exchange rate at the reporting date. The exchange rate gain and loss then match in the profit and loss account. The forward points of the forward foreign exchange contract must then be allocated to profit or loss over the term of the contract (DAS 290.633(a.3)).

21.7.4.4 Commencement of hedge accounting after the purchase of a hedging instrument

Applying hedge accounting is optional and therefore not mandatory. The decision to commence hedge accounting does not necessarily have to be made at the point when the hedge is deployed (i.e. when the hedging instrument is purchased). Therefore, a company may initially choose not to apply hedge accounting, but then to commence doing so later. Of course, at that point, all the conditions have to be met in that regard. Hedge accounting may then be applied (prospectively) from then on.

Example: Commencement of hedge accounting after the purchase of a hedging instrument

Company A takes out a loan in year 1 to finance the purchase of a business premises at a fixed interest rate. The bank provides a loan at a floating rate accompanied by a second contract (a swap contract) to convert the floating rate to a fixed rate. This swap contract has the same term to maturity and other critical terms as the loan contract. Both the amounts due under the loan contract and those under the swap contract are settled independently. The company uses (amortised) cost as the principle of measurement for both the loan and the swap contract. It does not apply hedge accounting. Over the course of the year, the floating rate falls and the fair value of the interest rate swap becomes negative. Consequently, at year-end 1, the derivative is impaired to this lower fair value (DAS 290.541) on the balance sheet, which is charged to the profit and loss account. A wonders whether cost hedge accounting may then be applied with effect from year 2.

It may do so from year 2 onwards, provided that it meets the documentation requirements. In cost hedge accounting, this means that starting from year 2, the liability (the negative value of the interest rate swap) is released *pro rata* to the term of the loan. That release is effectively a correction in the profit and loss account of the interest amounts settled under the interest rate swap due to the negative value recognised in year 1. Given that the loan (the interest cash flows of which are the hedged item) is measured at amortised cost using the effective interest method, it is obvious that the liability is also released according to the effective interest method. An alternative to this is straight-line amortisation if it does not produce significant differences compared to the effective interest method (see also paragraph 21.2).

21.7.4.5 Hedge of a net investment in a foreign operation

The above conditions for hedge accounting must be met when applying hedge accounting to a hedge of a net investment in a foreign operation. The treatment of this form of hedge accounting is similar to that of cash flow hedge accounting. See chapter 4 in this regard.

21.7.5 Discontinuation of hedge accounting

Hedge accounting should be discontinued if:

- the hedging instrument expires or is sold, terminated or exercised; the replacement or rollover of a hedging instrument into another hedging instrument is not regarded as expiration or termination if that replacement or rollover is part of the documented hedging strategy;
- it no longer meets the conditions for hedge accounting (see above); or
- the entity no longer chooses to apply hedge accounting based on its the documented and consistently applied policy or any change to it. This is in fact voluntary discontinuation of hedge accounting, which must be made clear by or amended in the hedging documentation.

Treatment of the discontinuation of fair value hedge accounting
The hedged item and the hedging instrument are remeasured from the moment hedge accounting is discontinued (i.e. prospective) on the basis of general accounting policies. Further adjustment to the carrying amount of a hedged financial instrument measured at cost is discontinued.

Treatment of discontinuation of cash flow hedge accounting
If cash flow hedge accounting is discontinued due to the hedging instrument having expired, been sold, terminated or exercised, the cumulative amount continues to be recognised in equity and is settled in the normal manner for a cash flow hedge. This also applies if hedge accounting is voluntarily discontinued, which may be done on the basis of the entity's documented and consistently applied policy or any change to it.

Cash flow hedge accounting should also be discontinued if the forecast transaction is no longer highly probable. If the forecast transaction is no longer highly probable but is still expected to take place, the cumulative amount continues to be recognised under equity and is settled in the normal manner for a cash flow hedge. However, if the forecast transaction is no longer expected to take place, the cumulative amount recognised under equity should be transferred to the profit and loss account (DAS 290.632).

Treatment of discontinuation of cost hedge accounting
If cost hedge accounting is discontinued due to the hedging instrument having expired, been sold, terminated or exercised, the cumulative profit or loss on the hedging instrument not yet recognised in the profit and loss account (i.e. during the period when there was an effective hedge) is recognised as an accrual on the balance sheet until the hedged transaction takes place (DAS 290.639(a)). The former hedging instrument is measured according to the basic rules for measurement and determination of profit or loss. This also applies if cost hedge accounting is voluntarily discontinued, which may be done on the basis of the entity's documented and consistently applied policy or any change to it.

Cost hedge accounting should also be discontinued if the future transaction is no longer highly probable. If the forecast transaction is no longer highly probable but is still expected to take place, hedge accounting is discontinued and the cumulative unrecognised amount is held off-balance sheet (e.g. if future cash flows are hedged) or recognised on the balance sheet (e.g. if foreign currency positions are hedged), depending on the situation, and is settled in the normal manner for a cost hedge. If the forecast transaction is no longer expected to take place, the cumulative amount not yet recognised in the profit and loss account (or held off-balance sheet) should be transferred to the profit and loss account (DAS 290.639(b)).

21.7.6 The impact of IBOR reform on hedge accounting

IBOR-linked interest rates (such as LIBOR, EONIA or EURIBOR) play a major role in financial markets and are used as reference interest rates in many financial instruments and other contracts. IBOR stands for Interbank Offered Rates. IBOR-linked interest rates in their current form will be phased out and, in some cases, replaced by new interest rates. For instance, ESTER, SONIA and SOFR will replace EONIA, GBP LIBOR and USD LIBOR, respectively. Transition periods apply. This has consequences for financial instruments and other contracts that include or refer to these interest rates.

The Dutch Accounting Standards Board has published two DASB Statements setting out considerations on the impact of the transition from IBOR-linked interest rates to alternative interest rate benchmarks ('IBOR reform'):

- DASB Statement 2019-17 on the impact on hedge accounting. This discusses whether hedge accounting may be continued ahead of the actual transition. The Dutch Accounting Standards Board concludes - in line with amended IFRS standards - that under the hedge accounting requirements set out in the Dutch Accounting Standards for medium-sized and large entities, any potential impact of the IBOR reform on the qualification of hedge relationships for hedge accounting is being ignored prior to the actual IBOR reform. It is still the case that ineffectiveness due to the IBOR reform must be recognised in accordance with the applicable requirements in DAS 290 (see paragraphs 21.7.4.2 and 21.7.4.3); and
- DASB Statement 2021-2, which proposes that no amendments be made to DAS 290 in order to address the potentially unwelcome impact of the IBOR reform on the recognition of modified contractual cash flows and on hedge relationships. According to this Statement, DAS 290 is more principles based than the new IFRS rules as regards these aspects. Therefore, in the Dutch Accounting Standards Board's opinion, no amendments are needed. Of course, this Statement also indicates that ineffectiveness due to the IBOR reform should be recognised in accordance with the relevant requirements in DAS 290.

21.8 Distinction between equity and liability in the consolidated financial statements

21.8.1 General

This paragraph focuses on the classification of a financial instrument as an equity or liability item (financial liability) in the *consolidated* financial statements. This classification depends on the economic reality of the contractual provisions, not their legal form. As regards recognition in *company-only* financial statements, a financial instrument may be classified as an equity or liability item based on its legal form or economic reality (DAS 240.207 and 208). This may result in differences between the consolidated and company-only financial statements. See chapter 14 as regards classification as equity or financial liability in the company-only financial statements.

An entity issuing a financial instrument (issuer) is required to classify the instrument, or the separate components of the instrument, as a financial liability, a financial asset or as equity in accordance with the economic reality of the contractual provisions and the provisions discussed below (DAS 290.801).

With the exception of certain puttable instruments (see below), a financial instrument (or a separate component of a financial asset or liability) is presented as equity in the following instances (DAS 290.802):

- the instrument does not include any obligation to deliver cash or any other financial asset to another party or an obligation to exchange financial instruments with another party on potentially unfavourable terms;
- if the instrument will or may be settled in equity instruments of the issuing entity, there should be no contractually agreed delivery of a variable number of equity instruments (there is only equity in the case of a fixed number of equity instruments);
- if it is a derivative on equity instruments of the issuing entity, such derivative may only be settled by exchanging a fixed number of equity instruments for a fixed amount.

21.8.2 Classification of financial instruments

No obligation to deliver cash or any other financial asset
An entity should not have any obligation to make a payment in cash or by delivery of another financial asset. It must always be able to prevent the outflow of funds (DAS 290.803). This is the principal feature of equity; shareholders providing an entity with capital that constitutes a permanent buffer. In doing so the economic reality of the contract terms must be established and not their legal form.

A contract that entails an obligation for the entity to purchase its own equity instruments for cash or any other financial asset includes a financial liability (DAS 290.806). For example, the entity may have entered into a forward transaction to repurchase its own shares or written a put option on its own shares.

The present value of the forward price or the present value of the exercise price of the put option, respectively, then constitute the financial liability. The initial recognition of a forward transaction to buy back own shares is as follows:

Other reserves	X	
Commitment to repurchase own shares		X

This financial liability is then recognised at amortised cost. If the contract expires without delivery being made, the financial liability is then reinstated to Other reserves at the expiry date (DAS 290.806).

A financial liability is therefore recognised even if the initiative to repurchase shares does not lie with the entity itself but rather with the counterparty, as is the case with the written option (DAS 290.807). The fact is that the entity cannot then unilaterally prevent the outflow of funds.

There is only equity if the entity has the unconditional right to avoid payment in cash or in other financial assets. This is not, therefore, the case if payment by the entity depends on uncertain future events or the outcome of uncertain circumstances. An exception is where the entity only has an obligation to settle in cash or other financial assets if it is liquidated (DAS 290.809).

'Puttable' equity instruments that may be settled at fair value
An exception to the main rules regarding the classification of financial instruments is made for the classification of what is referred to as puttable equity instruments. These instruments include a contractual obligation for the entity to repurchase the financial instrument. Such puttable equity instruments are in practice often issued by cooperatives and by open-ended investment funds. Minority interests held by third parties in group companies of the entity can also include puttable equity instruments. The put options then give the minority shareholders the right to sell the shares to the entity on set terms.

Puttable equity instruments are classified as financial liabilities under the definition and rules set out above. However, puttable instruments may be presented as equity if they contain all the following features (DAS 290.808):

- they entitle the holder upon liquidation to a *pro rata* share of the net assets in the company;
- they are subordinate to all other instruments;
- all these "most subordinated" instruments have the same characteristics; and
- the company does not hold any other financial instruments or contracts:
  1. whose forecast cash flows are largely based on profit or loss or on changes in the company's net assets; and
  2. that could largely limit or lock in the residual value of the puttable instruments.

The use of this method of presentation should be disclosed in the notes (DAS 290.808).

Minority/non-controlling interest
In the consolidated financial statements, the minority interest or non-controlling interest forms part of the group equity (Article 10(2) of the Decree on annual accounts format). This is therefore equity interest in group companies not held by shareholders of the consolidating parent entity. This non-controlling interest is also subject to the classification requirements of DAS 290. For example, DAS 290.805 states that if there is an obligation to repurchase a minority interest in a consolidated entity, the present value of any forecast payment must be recognised as a financial liability. This financial liability therefore has to be charged to group equity. This situation is possible as regards both (written) put options issued to minority shareholders and forward contracts without the option element with shares being delivered in accordance with the terms of the contract. DAS 290 does not prescribe any specific recognition method for this reduction in group equity. A logical treatment arising from the full consolidation technique is for the non-controlling interest in the group equity to initially be reduced by this liability. The fact is that this component does not add to group equity. If the liability exceeds the relevant non-controlling interest, the excess is charged to the parent entity's equity or the group equity attributed to the parent entity's shareholders.

See paragraph 33.7 for the further recognition of transactions between the parent entity and minority shareholders where the former retains control.

Preference shares
Preference shares constitute a financial liability if the entity has to repurchase them in the future for a fixed or determinable amount that is independent of profit. Even if dividend payments on the preference shares are perpetual (perpetual loan) and are fixed or determinable and independent of profit, those preference shares constitute a financial liability even if there is no obligation to redeem them in the future.

If dividend payments do depend on profit generated by the entity, there is a contingent liability to pay dividends. This obligation becomes unconditional if sufficient profit is generated in any year. Under IAS 32, this would result in classification of the preference shares as a financial liability because the nature of the dividend is effectively interest. This is because these dividends are compulsorily payable if and to the extent there are sufficient profit and/or distributable reserves available. DAS 290.810 provides an option between classification as equity or as a financial liability. This choice must be disclosed in the notes. In case of classification as equity, the amount paid is dividend and is charged directly to equity. If the instrument is classified as financial liability, the amount paid is recognised as interest paid and is charged to profit or loss.

The Dutch Accounting Standards Board provides the option of classification as equity or as financial liability because dividends are based on profit and profit has the characteristic of equity. Of course, these preference shares should then be redeemable on a non-compulsory basis and the dividend should not be so high (or increasing) that principal is then redeemed indirectly.

Furthermore, this choice only applies if there are (pure) profit-dependent payments. The Dutch Accounting Standards Board clarifies that profit-dependent payments are non-discretionary payments that take place only if sufficient profit has been realised in any year after the issuance of the instrument to make the payment (or part of the payment) for that year.

This means that if there is an obligation to make a payment when profit is realised, but the amount of this payment is higher than the profit realised, it is *not profit*-dependent in the context of the distinction between equity and financial liability. Such a payment shall not be split into a part that is profit-dependent and a part that is not. It means that if there are such non-profit-dependent payments, the instrument should be classified as financial liability.

Example: Cumulative preference shares with profit-dependent payments: option to recognise as equity or as financial liability (based on appendix 6 to DAS 290 "Financial instruments")

On 1 January, year 1, a company issues cumulative preference shares with a face value of 100,000 and a dividend of 5% per annum. When the shares are issued, the company has a freely distributable equity of 3,000.

In the first year after the issuance of the cumulative preference shares, the company realises a profit of 6,000. Of this, 5,000 (= 5% of 100,000) is paid out as preference dividend on the cumulative preference shares and 1,000 is be added to equity.

The second year after the issuance of the cumulative preference shares, the company realises a profit of 1,000. The profit is insufficient to pay the preference dividend of 5,000. A dividend of 1,000 is paid out on the cumulative preference shares and the holder retains the right to receive the remaining 4,000 on realised profits in the future.

In the third year, the company realises a loss of 5,000. No dividend is paid. The unpaid rights of the holder of the cumulative preference shares are 9,000. The freely distributable equity is negative 1,000.

In the fourth year, the company realises a profit of 6,000. There is not enough freely distributable equity to pay out the entire profit of 6,000, assuming that the company cannot pay out a dividend in the event of a negative equity. In that case, 5,000 will be paid out as preference dividend on the cumulative preference shares. The holder retains the right to receive 9,000 on realised profits in the future.

In the fifth year, the company realises a profit of 6,000. Now the entire profit of 6,000 can be paid out because the freely distributable equity is sufficient. The unpaid rights of the holder of the cumulative preference shares are 8,000.

The dividend is always paid from the realised profit in the financial year. The company therefore has the option to recognise this cumulative preference shares as equity or as a financial liability. In the case of classification as equity, the amount paid is dividend and is charged directly to equity. If the instrument is classified as financial liability, the amount paid out is recognised as interest paid and is charged to profit or loss.

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Profit		6.000	1.000	-5.000	6.000	6.000
Paid preference dividend		5.000	1.000	0	5.000	6.000
Freely distributable equity	3.000	4.000	4.000	-1.000	0	0
Unpaid dividend rights		0	4.000	9.000	9.000	8.000

Example: Cumulative preference shares with payments not-dependent on the profit: financial liability (based on appendix 6 to DAS 290 "Financial instruments")

The factual pattern is the same as in the previous example, except that there is an additional clause that stipulates that if and to the extent that the profit is not sufficient for payment of the full preference dividend on the cumulative preference shares, the shortfall is paid – as far as possible – from the freely distributable equity.

This means that the distribution on the cumulative preference shares is not dependent on future profits. Based on the factual pattern given in the previous example, this results in different payments in the second year and the fourth year:

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Profit		6.000	1.000	-5.000	6.000	6.000
Paid preference dividend		5.000	5.000	0	1.000	6.000
Freely distributable equity	3.000	4.000	0	-5.000	0	0
Unpaid dividend rights		0	0	5.000	9.000	8.000

In year 2, insufficient profit was realised to pay out the entire preference dividend. There is, however, freely distributable equity in the amount of 4,000. So 4,000 dividend is paid not dependent on the profit realised, which is only 1,000. The preference dividend is not paid out of the profit and is therefore a non-profit-dependent payment. The company classifies these cumulative preference shares as financial liability and therefore recognises the dividends as interest expense.

If a preference share is perpetual and the entity has no obligation to redeem it, with the option to pay dividend being at discretion of the entity (i.e. the management board, supervisory board or general meeting), this instrument qualifies as equity (DAS 290.805).

Loans without a repayment date
The above-mentioned provisions for preference shares without a repayment date also apply to loans without a repayment date. Again, if the interest payments are profit-dependent, there is an option to classify this loan as equity or as financial liability.

Example: A loan with profit-dependent payments: option to recognise as equity or as financial liability (based on appendix 6 to DAS 290 "Financial instruments")

The factual pattern is again the same as in the first example of cumulative preference shares, but instead of a cumulative preference share, the company issues a loan with an interest rate that is due if profit in the financial year is sufficient. The interest is 5% and is cumulative (it will still have to be paid if profit is made in a later year). In addition, the loan is perpetual and therefore has no mandatory redemption.

Since having sufficient freely distributable equity is not necessary for making interest payments, the mandatory payments on such a loan may differ from the payments on a cumulative preference share. The example below is based on the same facts as previous examples. However, the payout now consists of 5% cumulative interest on a loan instead of 5% cumulative dividend on cumulative preference shares.

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Profit		6.000	1.000	-5.000	6.000	6.000
Interest paid		5.000	1.000	0	6.000	6.000
Free distributable equity	3.000	4.000	4.000	-1.000	-1.000	-1.000
Unpaid interest		0	4.000	9.000	8.000	7.000

Since it is not necessary to have sufficient freely distributable equity for making interest payments, the entire realised profit can be paid out as cumulative interest in the fourth year. Because the interest payments are made exclusively from the profit realised in the financial year, they are profit-dependent payments. The company therefore has the option to classify this loan as equity or as financial liability.

In the case of classification as equity, the amount paid is dividend and is charged directly to equity. If the instrument is classified as financial liability, the amount paid out is recognised as interest paid and is charged to profit or loss.

Derivatives with a choice regarding settlement
If a derivative gives one party the right to determine how it is settled, it is a financial asset or financial liability, unless all settlement alternatives would result in it being an equity instrument (DAS 290.811). An example of this is a written share option where the entity issuing the financial instrument has the right, at its discretion, to settle the instrument on a net basis in cash or by issuing its own shares. This classifies as a financial liability.

Settlement in the form of a fixed or variable number of the entity's own equity instruments
In the situation where an entity has the right to receive a number of equity instruments (e.g. a sale of an asset that is to be settled in the entity's own shares), the question is whether there is a financial asset (a receivable) or a reduction of equity. Where an entity has a right to a fixed number of equity instruments, the amount received will increase or decrease depending on changes in the value of the entity's shares. Therefore, it then does not have a claim for a fixed cash amount. Instead, this is a reduction in equity (to be deducted from Other reserves). The fact is that the risk of a decrease or increase in value of the shares in this instance lies with the entity, not with the third party that is to deliver the shares. This is treated as though the shares had already been acquired (share repurchase deducted from Other reserves).

If the entity is entitled to a variable number of shares, the risk of decrease or increase in value lies with the third party. The entity is paid the amount of its claim in the form of shares; the number of shares delivered depends on the movement in their value. The risk then lies with the counterparty. The entity then has a financial asset (a receivable) until the actual delivery of the shares to the entity. The receivable is then derecognised against Other reserves.

Conversely, if the entity has a liability to a third party that is to be settled in the entity's own equity instruments and the number of shares is fixed, meaning that the amount varies, the risk therefore lies with the third-party creditor. The entity recognises this as an increase in equity (increase in Other reserves). When the shares are delivered, the shareholders' equity and share premium reserve are increased and Other reserves are reduced. Unless shares are delivered that had previously been repurchased, then no further entry is made.

However, if the entity has a liability at a fixed amount because the number of shares to be delivered varies, then the risk of a decrease or increase in the value of the shares lies with the entity and, therefore, it should be recognised as a financial liability. When the shares are delivered, the liability is derecognised and the shareholders' equity and share premium reserve are increased. Unless previously repurchased shares are delivered, in that case the Other reserves are increased and the issued capital remains unchanged.

The above can be summarised as follows:

Financial instrument that confers the right to a fixed number of equity instruments of the entity itself	Equity (is a reduction in equity; compare with repurchase of own shares)
Financial instrument that confers the right to a variable number of equity instruments of the entity/debtor (fixed amount for receivable to be recovered)	Financial asset
Financial instrument that entails an obligation to deliver a fixed number of equity instruments of the entity itself	Equity (is an increase in equity)
Financial instrument that entails an obligation to deliver a variable number of equity instruments of the entity itself (fixed amount for debt to be settled)	Financial liability

Examples of classification financial instruments as equity or financial liability
The table below gives examples of financial instruments and identifies the contractual terms according to which they are equity or financial liabilities (DAS 290.805):

	Relevant contractual terms	Presentation
A. Preference share, with or without cumulative dividend	The issuing entity must redeem the preference shares for a fixed or determinable amount (independent of profit) at a specified or determinable date in the future.	Financial liability
B. Preference share, with or without cumulative dividend	The issuing entity must make fixed or determinable dividend payments (independent of profit) in perpetuity.	Financial liability
C. Preference share, with or without cumulative dividend	The issuing entity has no obligation to repurchase or redeem the preference shares on a specific or determinable date in the future. The preference dividend is obligatorily payable if sufficient profit has been realised in any year after the issuance of the instrument to enable payment.	Option to recognise this instrument as equity or financial liability (see DAS 290.810).
D. Preference share, with or without cumulative dividend	The instrument is identical to the previous instrument in this table (C). However, the preference dividend (or part thereof) must also be paid if there is insufficient profit in any year after issuance of the instrument, but there is sufficient freely distributable equity.	Financial liability

	Relevant contractual terms	Presentation
E. A non-obligatory repayable loan with or without cumulative profit-dependent interest payments	The loan is perpetual and the entity has no obligation to repay the loan. The interest is obligatorily payable if sufficient profit has been realised in any year after the issuance of the instrument to enable payment.	Option to recognise this instrument as equity or as financial liability (see DAS 290.810).
F. Preference share, with or without cumulative dividend, where payment of dividend is at the entity's discretion	The share is perpetual and the entity has no obligation to repurchase it. Preference dividend payments are also at the discretion of the management board or supervisory board or pursuant to a resolution of the general meeting.	Equity
G. Loan to be repaid in the entity's own shares	The entity is obliged to deliver a variable number of equity instruments.	Financial liability
H. Call option purchased on own shares	The entity is entitled to repurchase a fixed number of its own equity instruments for a fixed consideration (compare repurchase of own shares).	Equity
I. Written call option on own shares	The entity is obliged to sell a fixed number of its own equity instruments for a fixed consideration.	Equity
J. Purchased put option on own shares	The entity has the right to sell its own shares to the holder of the put option.	Equity
K. Written put option on own shares	The entity is obliged to repurchase its own shares when the holder of the instruments exercises its put option. Similarly, if there is an obligation to repurchase a non-controlling interest in a consolidated entity, the presentation indicated on the right should be applied.	The put option (premium) is equity. However, a financial liability for the present value of the possible future payment is recognised at the issuance of the option, even if the obligation to repurchase depends on the future exercise by the counterparty. The liability is charged to equity (see DAS 290.807).
L. Forward transaction for the repurchase of own shares	The entity is obliged to repurchase its equity instruments in exchange for a certain amount of cash or another financial asset.	The forward transaction is equity (but generally has a value of zero at initial measurement) and, in addition, there is a financial liability in the amount of the present value of the redemption amount that is charged to equity when entering into the forward transaction (see DAS 290.807).

The classification of a financial instrument should be changed if the nature of the instrument has been altered by changes in contractual terms or corporate management decisions such that it can no longer be considered consistent with the economic reality.

21.8.3 Classification of compound financial instruments

Compound financial instruments are instruments that contain both an equity component and a liability component. An example is a convertible bond loan. For reporting periods beginning on or after 1 January 2018, it is mandatory to (1) assess instruments for the existence of such components and (2) classify the components separately as financial liabilities, financial assets or equity (DAS 290.813).

The classification of a component as either a liability or equity item also affects the profit and loss account and tax treatment. Costs of liabilities are recognised (as interest expense) in the profit and loss account. In contrast, equity costs are charged directly to equity (as dividend). The recognition of taxes on such payments is in line with the recognition of the payments themselves, i.e. either in profit and loss or in equity.

The initial measurement of a compound instrument whose components are classified separately is done by first determining the fair value of the liability component and then recognising the difference with the fair value of the entire compound instrument as an equity component. Thus, no amount other than the fair value of the entire instrument should ever be recognised. In addition, therefore, no gain or loss is recognised upon the initial recognition of a compound instrument (DAS 290.818). Transaction costs are allocated *pro rata* to the various components on initial recognition (DAS 290.819).

Example: Separation of a convertible bond into a liability component and an equity component

Company A issues 2,000 convertible bonds on 1 January. These bonds have a term of three years and a face value of 1,000 each when issued, meaning that the total value of the bond loan is 2,000,000. Interest at 6% per annum is charged annually in arrears. Until the expiry date of the conversion option, the bond holder is entitled to convert the bond at any time in exchange for 250 ordinary shares. When the bonds are issued, the market interest rate for a similar loan without a conversion option is 9%.

At initial recognition of the instrument first the liability component shall be measured. The difference between the amount received on the bond issue (this is the fair value of the instrument as a whole) and the fair value of the liability component is allocated to the equity component. The fair value of the liability component is calculated using a discount rate of 9% (this is the market rate received on a similar bond but without conversion options). The calculation is then as follows:

Fair value of the principal at maturity (= 2,000,000 / 1.09^3)	1,544,367
Fair value of the interest payments (= 120,000 / 1.09 + 120,000 / 1.09^2 120,000 / 1.09^3)	303,755
Fair value of the total liability component	1,848,122
Amount received on the bond issue	2,000,000
Fair value of the equity component	151,878

When recording the initial measurement, the issuer of the convertible bond makes the following entry:

Cash	2,000,000	
Bond loan		1,848,122
Other reserves (in accordance with DAS 240.210)		151,878

If the issue of a compound instrument involves transaction costs, they are allocated proportionally to the liability and equity components, taking into account the relative fair values of those separate components (DAS 290.819).

If the components of a compound instrument are presented separately on the balance sheet, the classification of a convertible instrument is not revised if there is a change in the likelihood of the conversion being exercised, even if the exercise of the conversion appears to have become economically advantageous to certain holders. The entity’s contractual obligation to make future payment remains outstanding until it is extinguished through conversion (DAS 290.816).

21.8.4 Purchase of own shares

See chapter 14 as regards the treatment of own share purchases.

21.8.5 Classification of interest, dividends, gains and losses

The classification of a financial instrument on the balance sheet determines whether interest, dividends, gains and losses relating to that instrument are classified as revenue or as costs and recognised in the profit and loss account. It follows that dividend payments on shares classified as liabilities are recognised in the profit and loss account as costs in the same way as interest on a bond loan. Similarly, gains and losses resulting from repayments or the refinancing of instruments classified as liabilities are also recognised in the profit and loss account. Distributions to holders of equity instruments and any effects of repayments or the refinancing of instruments classified as equity instruments of the issuer are recognised directly in equity, taking into account any associated deferred taxes (DAS 290.821-824).

21.9 Presentation

21.9.1 Presentation as a current or non-current financial asset

The general provisions of DAS 190.2 apply to the presentation of a financial asset as current or non-current. Please refer to paragraph 2.11 as regards these provisions.

21.9.2 Presentation as current or non-current financial liability

Please refer to paragraph 19.4.1 as regards the presentation of a financial liability as current or non-current.

21.9.3 Netting

General
A financial asset and a financial liability are netted if the general netting conditions of DAS 115 are met (DAS 290.837). The entity should have a legally enforceable right and should also have the firm intention to settle these instruments on a net basis or simultaneously.

The existence of an enforceable right to settlement of a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability. It can significantly affect the extent to which an entity is exposed to credit and liquidity risk.

In the absence of a firm intention to exercise the right of settlement, the amount and timing of an entity's future cash flows will not be affected by the existence of this legal or agreed right. The credit risk to which the entity is exposed in respect of the receivable remains for the full amount if the liability is paid before the receivable under the financial asset is received. This explains why there should be no on-balance sheet netting in such a situation.

A right of settlement is a contractual right or otherwise the right of a debtor to settle all or part of an amount owed to a creditor by settling it against an amount owed to the same creditor. In very special circumstances, company X may have a right to settle an amount due to party Y against an amount receivable from party Z. Since Y and Z are different parties, this requires a contract between the three parties involved that clearly sets out the debtor's right of set-off.

A right of settlement is not in itself sufficient for netting. There should also be a firm intention to settle on a net basis or simultaneously. An intention by either party to settle on a net basis where there is no contractual right to do so does not justify netting. This is because the rights and obligations associated with the separate financial asset and liability remain unchanged (DAS 290.841).

Two financial instruments are settled simultaneously if, for example, in the case of a clearing organisation in an organised market, or if they are simultaneously transferred by the parties involved. The transfers have to be simultaneous. There should be no risk due to any difference in timing between the settlements made, because that would still leave a substantial credit risk for the full amount of the asset and a liquidity risk for the full amount of the liability (DAS 290.842).

A so-called master netting contract does not automatically provide a basis for netting unless all the netting conditions set out above are met. A masting netting agreement provides for the settlement in one net amount of all financial instruments entered into with a particular party and defined in that contract in the event of default by either party. If financial assets and financial liabilities covered by such a contract are not (or cannot be) netted, the effect of the contract on credit risk (lower risk) is then disclosed (DAS 290.843).

Examples of non-compliance with the netting conditions
The netting conditions are generally not met and netting is usually not appropriate if:

- various different financial instruments are used to emulate the features of a single financial instrument (a so-called "synthetic instrument");
- financial assets and financial liabilities arising from financial instruments have the same primary risk exposure but different counterparties (e.g. assets and liabilities within a portfolio of forward contracts or other derivative financial instruments);

- financial or other assets are pledged as collateral for financial liabilities and the creditor has a right of recourse to solely those assets;
- financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation; or
- obligations incurred as a result of events giving rise to losses are expected to be covered by a third party by virtue of a claim made under an insurance policy.

21.10 Disclosure

21.10.1 Disclosure requirements under DAS 290

General
The purpose of providing information on financial instruments is twofold. On the one hand, disclosures are required to provide an understanding of the significance of financial instruments for the financial position, profit or loss and cash flows of legal entities and, on the other hand, to provide an understanding of the amounts, timing and certainty of future cash flows of financial instruments (DAS 290.901).

Determining the level of detail of disclosures about certain financial instruments requires an assessment that takes account of their relative importance (DAS 290.904). An appropriate balance has to be struck to avoid overloading the financial statements with detailed information on the one hand and avoiding over-aggregation on the other hand.

DAS 290 includes disclosure requirements over and above the legal ones. Disclosure of additional information may be necessary to provide the understanding required by law. This should also take into account the stated purpose of providing information on financial instruments and the associated risks.

Basis for measurement and determination of profit or loss
The following data on measurement and determination of profit or loss should be provided:

- information about the nature and extent of the financial instruments, including significant contractual terms that could affect the amount, timing and degree of certainty of future cash flows (DAS 290.906(a));
- the accounting policies, including the criteria for recognition of financial instruments on the balance sheet and the measurement methods applied (DAS 290.906(b));
- the methods and assumptions used to determine the fair value of financial instruments measured at fair value, separately for significant groups of financial assets (DAS 290.912(a));
- whether gains and losses arising from changes in the fair value of those financial assets measured at fair value after initial recognition, other than those held for trading, are recognised in profit or loss for the period or recognised directly in equity until the financial asset is disposed of (DAS 290.912(b));
- whether regular-way purchases and sales of financial assets are recognised at transaction date or at settlement date (DAS 290.912(c)).

Contractual terms and conditions
The contractual terms and conditions of a financial instrument can have a significant impact on the amount, timing and degree of certainty of future cash flows for the parties to a financial instrument.

When financial instruments are significant, either individually or as a class, to the financial position of an entity or its future operating profits, information is provided about their contractual terms and conditions. This applies to both on-balance-sheet and off-balance-sheet instruments (DAS 290.907).

For instance, derivatives are commonly entered into under the standard documentation prepared by the International Swaps and Derivatives Association (ISDA). ISDA has drafted two master contracts, namely the ISDA Master Agreement 1992 and the ISDA Master Agreement 2002. These master contracts contain a large number of standard terms and conditions that parties may or may not apply to the derivatives contracts they conclude under them. If parties agree to provide collateral to each other under certain conditions, those agreements are recorded in a Credit Support Annex (CSA). If the fair value of a derivative changes significantly as a result of interest rate movements, this could mean that a potential claim against the counterparty under the derivative increases to such an extent that one of the parties becomes exposed to the risk that, on balance, the other will no longer be able to meet its obligations under the derivative. To mitigate this risk, a CSA could agree that if the fair value of a derivative falls below a certain level, the company must deposit an amount of collateral on deposit (or provide some other form of security), as collateral for the counterparty.

Example: Contractual terms and conditions

A company enters into an interest rate swap under which it pays a fixed interest rate and receives a floating interest rate. If the fair value of this derivative falls below a certain level, the company must deposit an amount in collateral. These deposits are referred to as margin calls and give the counterparty to the interest rate swap some assurance that the other party will be able to continue to meet its obligations in that regard. Margin calls also work the other way. In the event of a positive fair value, the counterparty to the interest rate swap should provide a guarantee and deposit funds as collateral for the company. This insures both parties against the consequences of large interest rate fluctuations. If the interest rate swap includes a margin call, it generally results in a lower fixed interest rate payable by the company entering into the interest rate swap than if no margin call is included. It also generally increases the possibility of entering into interest rate swaps with longer terms to maturity with higher underlying values. Additional terms may be agreed for margin calls. For example, it can be agreed that a margin should have a minimum value, referred to as a threshold.

The risk of margin calls being made is a liquidity risk for the company. If they block a significant portion of liquidity, that could leave a company with insufficient liquidity to meet its current obligations. Note that the funds segregated under margin calls are not transferred to the counterparty of the interest rate swap and therefore do not generate a loss. However, they can no longer be used for investments or to meet other obligations.

Thus, if financial instruments held or issued by the entity - either individually or as a class - are exposed to a significant degree of risk, it may be necessary to explain their contractual terms and conditions. These include, in particular, exposure to cash flow risk, credit risk, liquidity risk, market risk, price risk, interest rate risk or currency risk.

Contractual terms and conditions that warrant disclosure include (DAS 290.908):

a. the principal, face or other similar amount which, for certain derivative financial instruments, may be the amount (referred to as the notional amount) on which future payments are based;
b. the date of repayment, expiry or exercise;
c. early settlement options held by either party to the instrument, including the period in which, or date at which, the options can be exercised and the exercise price or range of possible exercise prices;
d. options held by either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other asset or liability, including the period in which, or date at which, the options can be exercised and the conversion or exchange ratio(s);
e. the amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including instalment repayments and any sinking fund or similar requirements;
f. the agreed rate or amount of interest, dividend or other periodic return on principal and the timing of payments;
g. the collateral obtained, in the case of a financial asset, or pledged, in the case of a financial liability;
h. in the case of an instrument whose cash flows have a currency unit that differs from the presentation currency, the currency in which receipts or payments are required, preferably presented in the form of an aggregate statement of positions for each foreign currency;
i. if the instrument provides for an exchange, information described in items a. to h. above for the instrument to be acquired with the exchange; and
j. any condition of the instrument or an associated term or conditions that, if it comes into effect, would significantly alter any of the other terms. For example, a provision for a minimum solvency ratio in a debt contract, which, if the ratio is exceeded, would make the entire loan immediately due and payable. See also paragraph 19.5.2.

If the presentation of a financial instrument on the balance sheet differs from the economic reality of the instrument, the notes should disclose the nature of the instrument (DAS 290.909). This may be the case if the classification of a financial instrument as equity or liability in the company-only financial statements is based on the legal form of the instrument (under DAS 240.207). If the balance sheet presentation of a financial instrument differs from the instrument's legal form, it is desirable to explain the nature of the instrument (DAS 290.909).

Interest rate, cash flow and liquidity risk
For each class of financial assets and financial liabilities, both recognised and unrecognised on the balance sheet, the entity should disclose information about its exposure to interest rate, cash flow and liquidity risk, indicating at least the contractual repricing or redemption dates (whichever is earlier) and the effective interest rates, when applicable (DAS 290.918).

Information on interest rate, cash flow and liquidity risk should include the effects of hedging instruments (DAS 290.918). The recommendation is for this information to be provided both including and excluding the effect of hedging instruments, with a breakdown by relevant and entire terms to maturity.

It is recommended that information on the impact that a future change in the applicable interest rate may have should be included in a summary overview. Information on maturities, or interest rate revision periods to the extent that they are shorter, indicates the *period for which* interest rates are fixed. Information on effective interest rates indicates the *level at which* interest rates are fixed. These data provide financial statement users with a basis for assessing the interest rate risk incurred by the entity and understanding the potential income or expenses resulting therefrom (DAS 290.919-920).

It is also recommended to disclose which financial assets and financial liabilities (DAS 290.922):

a. are subject to interest rate risk, such as monetary financial assets and financial liabilities with a fixed interest rate;
b. are subject to interest cash flow risk, such as monetary financial assets and financial liabilities with a variable interest rate that is adjusted when market interest rates change;
c. are not subject to interest risk, such as certain investments in shares and the like.

Credit risk
For each class of financial assets and financial liabilities, both recognised and unrecognised in the balance-sheet, the entity should disclose information about its exposure to credit risk, including, at a minimum (DAS 290.928):

a. the amount that best represents the maximum credit risk at the reporting date in the event that counterparties default on their obligations under financial instruments (without taking into account the fair value of collateral obtained); and
b. disclosure of significant concentrations of credit risk.

In accordance with Article 2:387(4) NCC, the notes to the financial statements must include all the following additional information relating to financial instruments: information on the nature and amount of any impairment or reversal thereof recognised for a financial asset in the balance sheet, separately for each significant category of financial assets (DAS 290.929).

In addition, (DAS 290.929):

a. a borrower discloses the carrying amount of the financial assets that it has pledged as security for liabilities and discloses all significant terms and conditions of such pledged assets; and
b. a lender discloses the following:
   - an indication of the fair value of the pledged assets (both financial and non-financial) that the lender is free to sell or pledge as security to third parties, if the fair value less the estimated cost of enforcement is less than the carrying amount of the financial asset and as long as there is no bankruptcy;
   - an indication of the fair value of obtained pledged assets that are sold or pledged as security to third parties; and
   - all significant terms and conditions relating to the use of the collateral.

Fair value
For each class of financial assets and financial liabilities, both recognised and unrecognised on the balance sheet, the entity is required to disclose its fair value unless the difference between the carrying amount and the fair value is immaterial. The amount of the fair value need not be stated to the extent that the financial assets or financial liabilities are already measured at fair value on the balance sheet. Inclusion of fair value disclosures in the notes also includes disclosure of the method used and the principal assumptions used in its application. On this basis, fair value disclosures should therefore also be made for "normal" receivables and payables.

If it is not possible to determine the fair value of a financial asset or financial liability in a sufficiently reliable manner within a reasonable time or at a reasonable cost, that fact should be disclosed along with information about the principal features of the instrument in question that determine its fair value (DAS 290.938). Disclosures on the fair value of financial instruments should also include whether and how deferred tax liabilities have been taken into account (DAS 290.937). If fair value information is not disclosed in the notes because the fair value cannot be determined with sufficient reliability, as much qualitative information as possible should be disclosed to assist users of the financial statements in forming their own judgements about the extent of possible differences between the carrying amounts of financial assets and financial liabilities and their fair values (DAS 290.941).

For financial assets and financial liabilities measured at fair value, it should be indicated whether those values were derived from quoted market prices, independent appraisals, present value (DCF) calculations or whether another appropriate method was used. In addition, the significant assumptions used in determining fair value should be disclosed (DAS 290.916).

If an instrument is not traded in an active financial market, it could be insufficient to determine and disclose just one value representing the estimated fair value. Instead, it may be more relevant to include a range of values in the notes within which fair value is likely to lie.

Financial assets measured at more than fair value
To the extent that financial assets are recognised at a carrying amount in excess of fair value, the carrying amount and fair value of the individual assets or the relevant groups of those individual assets are disclosed together with the reasons for not reducing the carrying amount, including the fact on which the management of the entity bases its belief that the carrying amount can be realised (DAS 290.943).

Hedge accounting
The disclosures required as regards hedge account include the following:

- a description of the entity's financial risk management objectives and policies, including its policy for hedging of major types of forecasted transactions (DAS 290.913(a);
- when applying hedge accounting (fair value hedge accounting, cash flow hedge accounting, cost hedge accounting and hedge accounting of a net investment in a foreign operation) (DAS 290.913(d)):
    - a description of the entity’s hedging strategy;
    - a description of the financial instruments designated as hedging instruments for the hedge transaction and their fair value at the reporting date;
    - the nature of the risks to be hedged;
    - for hedging forecast transactions (cash flow hedge accounting): the periods in which these transactions are expected to occur, the dates when the transactions will be included in determining profit or loss and a description of forecast transactions for which hedge accounting was previously used but which are no longer expected to occur;
- where a gain or loss on a hedging instrument used for a cash flow hedge is temporarily recognised in equity (DAS 290.913(c)):
    - the amount recognised in equity during such period;
    - the amount derecognised from equity during such period and recognised in the profit and loss account;
    - the amount derecognised from equity during such period and included in the initial measurement of assets and liabilities;
- where a hedge relationship creates a significant cash flow risk (DAS 290.913(e)):
    - its nature;
    - its size;
    - the relevant circumstances; and
    - when cash flows and/or liabilities could occur;
- where hedge accounting is applied (DAS 290.913(f)):
    - the cumulative fair value change of the hedging instruments related to the effective part of the hedge; and
    - the cumulative fair value change of the hedging instruments related to the ineffective part of the hedge. This should also indicate the cumulative amount recognised in the profit and loss account.

There could be a significant cash flow risk if, for example, the interest rate of a floating rate loan is hedged with an interest rate swap, where the swap contract includes an exchange of cash collateral in the amount of the fair value.

Another example is the hedging of a future currency risk using a rollover strategy with short-term forward foreign exchange contracts settled periodically.

21.10.2 Legal disclosure requirements

General
The legal disclosure requirements are summarised and explained below. The disclosure requirements included in DAS 290 are partly based on these legal provisions. DAS 290 includes further disclosure requirements in addition to the legal ones. They focus in particular on the disclosure of the risks associated with the use of financial instruments. We refer to paragraph 21.10.1 in this regard.

Legal disclosure requirements regarding fair value measurement
If financial instruments are measured at fair value, Article 2:381a NCC requires specific disclosures in the notes. If fair value has been determined using measurement models and techniques, the underlying assumptions should be disclosed.

In addition, for each category of financial instruments, the fair value and the impact of the fair value measurement on reserves recognised on the balance sheet as well as on the profit and loss account should be disclosed. In this regard, the law requires disclosure of both changes in value recognised directly in the profit and loss account and changes in value reflected in the revaluation reserve on the balance sheet.

Additional disclosures are required for each category of derivative financial instruments (derivatives) due to the risk they carry. Of interest are the size and nature of these instruments. Relevant conditions that may affect the amount, timing and certainty of future cash flows should also be disclosed in the notes. This allows users of the financial statements to form an opinion on future fair value.

Legal disclosure requirements for measurement at cost
Under Article 2:381b(a) NCC, if financial instruments are not measured at fair value, the entity discloses in the notes information about their fair value, nature and size for each category of derivative financial instruments.

According to the second sentence of Art. 2:387(4) NCC, financial instruments that are financial fixed assets can be measured at a value lower than historical cost. The fact is that, 2:381b(b) NCC prescribes what information must be provided if the provisions of Article 2:387(4) NCC have not been exercised in relation to such instruments measured at cost. This means that the entity's financial statements measures these instruments higher than their fair value. An example is a held-to-maturity bond measured at its (amortised) cost, where the fair value is less than this cost. In such a situation, the notes must state the following pursuant to Article 2:381b(b) NCC:

- the fair value of individual assets or appropriate groups of individual assets;
- the reason why the carrying amount was not adjusted to fair value and therefore why no loss was recognised. The entity also explains why it is convinced that the higher carrying amount can be realised.

21.11 Exemptions for medium-sized and small entities

No legal exemptions apply to medium-sized entities.

Medium-sized entities are exempt from the following requirements as regards disclosure:

- interest rate and cash flow risk (DAS 290.918); however, the legal disclosures on the remaining term and interest rate do apply (Article 2:375(2) NCC); and
- credit risk (DAS 290.928).

Medium-sized entities may therefore limit information to the liquidity risk. However, disclosures on interest rate and cash flow risk are recommended for medium-sized entities.

There is nothing in the Dutch Accounting Standards for micro-sized and small entities about embedded derivatives or whether or not to segregate them.
Nor does the Dutch Accounting Standards for micro-sized and small entities contain any reference to the standards for large and medium-sized entities in this regard. Nor does Title 9 Book 2 NCC include any provisions about this. As

the Dutch Accounting Standards for micro-sized and small entities does not address this issue and does not refer to the Dutch Accounting Standards for medium-sized and large entities either, small entities themselves must choose an accounting method that provides relevant and reliable information on which the users of the financial statements can base their decision-making (DASsmall A1.202).

Small entities need only include the legal required information in the notes and may consider incorporating additional information ("over and above the legal minimum").

21.12 Significant differences from IFRS

General
The Dutch Accounting Standards Board has adopted certain recognition and measurement rules from IFRS (in particular IAS 39 ’Financial Instruments: Recognition and Measurement’ - the predecessor of IFRS 9 ’Financial Instruments’. Also several measurement rules that differ from IFRS are included. One reason is that the Dutch Accounting Standards Board does not want to restrict the legal framework. Another reason is that some mandatory legal requirements have to be taken into account. This means that there are significant differences between DAS 290 and IFRS as regards the recognition and measurement of financial instruments. DAS 290 recognises the wider legal option of measuring financial instruments, including derivatives, at cost. In contrast, IFRS requires various financial instruments, including derivatives, to be measured at fair value. Key differences between DAS 290 and IFRS are discussed in more detail below.

In July 2014, the IASB published a completely new standard, IFRS 9 Financial Instruments. IFRS 9 contains amended provisions compared to IAS 39 as regards the classification and measurement of financial instruments, impairment of financial instruments and hedge accounting. IFRS 9 applies to financial years that began on or after 1 January 2018. After analysing IFRS 9, the Dutch Accounting Standards Board decided not to make any changes to DAS 290 except for facilitating the impairment provisions of IFRS 9. An alternative option is to apply the provisions of IFRS 9 for determining the impairment and uncollectibility of:

- purchased loans and bonds (not included in the trading portfolio);
- loans granted and other receivables, including lease receivables and debit balances under construction contracts or contracts for the sale of goods or provision of services; and
- contracts for financial guarantees and loan commitments

instead of the provisions of DAS 290.533 to 540 in the financial statements. This alternative involves determining the impairment and uncollectibility of the listed instruments according to IFRS 9's ’expected credit loss model’ of IFRS 9 instead of DAS 290 ’incurred credit loss model’. The disclosures on impairments described in IFRS 7 Financial Instruments Disclosures are then also required (DAS 290.101).

A transition to IFRS 9's ’expected credit loss model’ represents a change in accounting policy. This must be recognised in accordance with DAS 140 Changes in accounting policies (see chapter 3); the comparative figures do not, however, need to be adjusted (DAS 290.1017).

Classification of financial assets
Under IFRS 9, a financial asset is measured at amortised cost if it meets the following criteria:

- it is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows (“business model test”); and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (contractual cash flow characteristics test).

A financial asset is measured at fair value through Other comprehensive income (FVOCI) if it meets the following criteria:

- it is held within a business model whose objective is both to collect contractual cash flows from the assets and to sell the assets (’business model test’); and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (contractual cash flow characteristics test).

When recognised at FVOCI, interest income and impairment losses are recognised in the profit and loss account. The difference between these items and the total change in fair value is recognised in OCI. A change in fair value due to a change in market interest rates is also recognised in OCI. A cumulative gain or loss recognised in OCI is transferred to the profit and loss account when the asset in question is no longer* recognised on the balance sheet (also known as recycling). Interest income and impairment losses are therefore recognised in the same way as for assets measured at amortised cost.

Financial assets that do not meet the above criteria are measured at fair value through profit or loss (FVTPL). Examples include shares, derivatives and most hybrid instruments. The business model is not relevant to these examples. Irrespective, the features of these instruments are such that they fail the contractual cash flow characteristics test. Bonds may well meet the contractual cash flow characteristics test. However, if they are held within a business model whose objective is not to hold bonds in order to collect contractual cash flows but to sell them, they should be measured at fair value. As regards equity instruments (e.g. shares), an entity may elect at initial recognition to recognise them at FVOCI. One of the criteria for this, however, is that these instruments are not part of the trading portfolio.

Under NL GAAP, the classification of financial assets is very different from that under IFRS 9. We refer to paragraph 21.6.4.

Embedded derivatives in financial assets
Under IFRS 9, embedded derivatives included in a contract whose host contract meets the definition of a financial asset ('financial asset host') should be classified as one indivisible financial asset. One example is an investment in a convertible bond. According to DAS 290.827, in principle, all embedded derivatives should be separated if certain criteria are met.

Financial guarantee contracts
Financial guarantee contracts that do not meet the definition of a derivative are not within the scope of DAS 290 but are (in principle) within the scope of IFRS 9. This difference can be particularly important in the company-only financial statements when applying combination 3 (NL GAAP) or 4 (IFRS). An example of this is a parent entity acting as guarantor for certain debts incurred by its subsidiary.

Measurement of derivatives and the application of cost hedge accounting
Under IFRS 9, derivatives are measured at fair value through profit or loss (FVTPL). DAS 290 also allows derivatives to be measured at cost under certain conditions. Given that derivatives may not be measured at cost under IFRS, IFRS does not provide for cost hedge accounting either.

Classification of preference shares
According to DAS 290.810, an entity may choose to classify preference shares (with cumulative or non-cumulative dividends) where payment of dividend is contingent on sufficient profit in any year as equity or as liability in the consolidated financial statements. According to IAS 32 Financial Instruments: Presentation, such preference shares are classified as a financial liability (IAS 32.AG26).

Puttable instruments
Under IAS 32, puttable instruments must be presented as equity if they include all the following features:

- they entitle the holder upon liquidation to a *pro rata* share of the net assets in the company;
- they are subordinate to all other instruments;
- all these "most subordinated" instruments have the same characteristics; and
- the company does not hold any other financial instruments or contracts:
  1. whose forecast cash flows are largely based on profit or loss or on changes in the company's net assets; and
  2. that could largely limit or lock in the residual value of the puttable instruments.

For such instruments, DAS 290 offers a choice between classification as either a liability or equity.

Recognition and derecognition of financial instruments
As regards the recognition and derecognition of financial instruments, DAS 290 refers to DAS 115, which contains general provisions for the recognition and derecognition of assets and liabilities. This means that recognition and

derecognition are determined by considering the economic rights and risks associated with assets and liabilities. IFRS 9 includes more comprehensive provisions than DAS 290 in this regard.

IFRS also has detailed provisions for determining whether there is a new loan or the continuation of an existing loan (financial liability) when the loan terms are changed between lender and borrower or in other situations where the loan terms are changed (IFRS 9.3.3.2). The Dutch Accounting Standards do not contain specific provisions on this.

Change in terms while financial instrument remains recognised on the balance sheet
A financial instrument measured at amortised cost whose contractual terms are altered without that significantly changing the economic reality continues to be recognised on the balance sheet. If the contractual cash flows change as a result, the following recognition methods are possible according to DAS 290:

a. recognition of the effect of the modified contractual cash flows directly in profit or loss; or
b. recognition of the effect of the modified contractual cash flows over the remaining expected life of the financial instrument by adjusting the effective interest rate.

IFRS prescribes the first of these two methods. See also the examples given in paragraph 21.6.4.6.

Transaction costs on the issue of equity instruments
Under DAS 240, transaction costs on the issue of equity instruments are not mandatorily deducted from equity, as under IFRS, but by law may also be capitalised under intangible fixed assets. However, the Dutch Accounting Standards Board recommends not using this legal option.

Applying the fair value option to financial liabilities
Under Article 10(2) BAW, the fair value option included in IFRS 9 may not be applied to financial liabilities. Because Title 9 Book 2 NCC does not allow the fair value option for financial liabilities, DAS 290 does not include it. The fact is that, according to Article 10(2) BAW, liabilities are only measured at current value if they are:

- financial instruments that are part of the entity's trading portfolio;
- derivative financial instruments; or
- insurance liabilities or pension liabilities.

When applying the fair value option under IFRS 9, an entity may, subject to certain conditions (including preventing or significantly reducing an accounting mismatch), designate financial instruments (including financial liabilities) at initial recognition as financial instruments measured at fair value through profit or loss.

Hedging documentation
Under IFRS 9, hedging documentation must be prepared for each individual hedge relationship. It also provides that, in addition to the requirements under DAS 290, the hedging documentation explicitly addresses the following requirements:

- there is an economic relationship between the hedged item and the hedging instrument;
- the effect of credit risk does not dominate the value changes that results from that economic relationship; and
- the hedge ratio of the hedge relationship is equal to that resulting from the amount of the hedged item that the entity actually hedges and the amount of the hedging instrument that the entity actually uses to hedge that amount of the hedged item.

DAS 290 does not prescribe mandatory hedging documentation for each individual hedge relationship. Hedge accounting can also be done on the basis of generic documentation describing the types of hedge relationships. All hedging instruments that qualify for hedge accounting within this policy are recognised according to hedge accounting rules. DAS 290 does, however, allow hedge accounting based on the documentation of each individual hedge relationship.

Annex 1. Examples of hedge accounting

This annex gives examples of the following in the order shown:

- fair value hedge accounting;
- cash flow hedge accounting;
- cost hedge accounting; and
- hedge of a net investment in a foreign operation.

1.1 Examples fair value hedge accounting

Example: Fair value hedge accounting (1) (hedge of a currency risk using a forward foreign exchange contract)

Company A receives a loan (USD 1 million) on 30 June from its US parent entity with a repayment date of 31 December. The price of USD 1 on 30 June 2008 is EUR 1. To hedge the currency risk on this loan, a forward foreign exchange contract is entered into on 31 August under which A buys USD 1 million on 31 December at a forward rate of USD 1 = EUR 1. Let us assume that the hedge of the currency risk is fully effective. Given this hedge, the following entries (in EUR) are made on 31 August (exchange rate: USD 1 = EUR 0.95):

Revaluation of the loan to the exchange rate as at 31 August (in EUR):

Loan	50,000	
Exchange rate gain		50,000

Valuation of the forward contract at 31 August (in EUR):

Exchange rate loss	50,000	
Forward foreign exchange contract		50,000

On balance, profit or loss is neutral as the decrease in the loan (gain) is offset by a loss on the foreign exchange forward contract.

The exchange rate remains fixed between 31 August and 31 December. Settlement of the forward foreign exchange contract at 31 December (in EUR):

Forward foreign exchange contract	50,000	
Bank		50,000

The forward foreign exchange contract is onerous and has to be settled with the counterparty.

Loan settlement at 31 December (in EUR):

Loan	950,000	
Bank		950,000

This entry relates to the repayment of the USD amount of EUR 950,000. Combined, the above two entries result in a payment of EUR 1,000,000 (fixed rate of USD 1 = EUR 1). Consequently, the forward foreign exchange contract concluded on the loan is onerous, as an exchange gain of EUR 50,000 would have been realised without it.

However, the hedge is 100% effective because the exchange rate gain on the loan is fully offset by the fall in the value of the forward foreign exchange contract.

Example: Fair value hedge accounting (2) (minimising ineffectiveness by excluding time value of option)

Company A has 1,000 shares of company X which are each worth 50. A does not classify these shares as part of its trading portfolio and recognises changes in their fair value directly in its equity (revaluation reserve). A wants to hedge the price risk. A therefore buys an at-the-money put option (i.e. it includes a sale price for 50) on 1,000 shares of X which will expire in three years. The price of this put option is 9,000.

A designates the intrinsic value of the put option as a hedging instrument for fair value hedge accounting purposes, with the investment in X being the hedged item. This hedging strategy is consistent with A's established risk management. A determines the effectiveness of the hedge by comparing the decrease in the fair value of the investment below the agreed sale price of 50 with the quarterly change in the intrinsic value of the option. The time value of the option is disregarded when determining the effectiveness of the hedge.

Since the hedging instrument and the hedged item have the same basis and are based on the same number of shares, it is plausible to assume that increases in the intrinsic value of the options are fully effective in offsetting declines in the fair value of the investment in X.

In this example, the entire amount paid (9,000) to acquire the option is a time value, because the option purchased was 'at-the-money' when purchased. This time value and further adjustments to the time value are recognised directly in the profit and loss account. It is better to determine the hedge effectiveness based on the option's intrinsic value rather than its fair value. This is because the fair value of the option also changes due to the other variables such as volatility and the risk-free interest rate. The time value component therefore reflects the effect of all variables in the price of the option, other than the intrinsic value. Since the hedge effectiveness is determined based on the option's intrinsic value, the time value is not part of the hedge position. Changes in the time value of the option are therefore recognised directly in the profit and loss account.

If the fair value of the shares falls below the agreed selling price of 50, the company then recognises any adjustment in the fair value of the hedged item below this amount in the profit and loss account (instead of in equity), which will be offset against the intrinsic value of the hedging instrument that is recognised in the profit and loss account in the same period. The fact is that if the hedged item is measured at fair value directly through equity, this is maintained if fair value hedge accounting is applied. However, changes in value attributable to the hedged risk are recognised in profit and loss. Only changes in value not attributable to the hedged risk are recognised in equity (revaluation reserve) (DAS 290.619).

1.2 Examples of cash flow hedge accounting

Example: Cash flow hedge accounting (1) (hedge of interest rate risk using interest rate swap)

Company A takes out a loan of 100 million with a variable interest rate and a five-year term on 1 January of year 1. The floating rate on the loan is EURIBOR plus 200 basis points. EURIBOR at the start of the loan is 5%. Interest on the loan is calculated on an annual basis and is revised annually on 31 December based on EURIBOR.

On 1 January of year 1, A enters into an interest rate swap with a notional amount of 100 million, the agreement being that A will receive a fixed interest rate in exchange for the EURIBOR interest rate for five years. The swap is designed to hedge the risk of variability in the interest cash flow payable. The interest rate swap is put on the market at the start of the loan and its fair value at that point is zero.

The terms of the interest rate swap are as follows:

Notional amount:	100 million
Transaction date:	1 January of year 1
Commencement date:	1 January of year 1
Expiry date:	31 December of year 5
Company A pays:	5.5% interest per annum
Company A receives:	EURIBOR
Payment and receipt dates:	annually at the repayment dates
Review of floating rate (EURIBOR):	annually at 31 December
First date of payment and receipt:	31 December of year 1
Last date of payment and receipt:	31 December of year 5

The interest rate swap is considered highly effective because the terms of the loan and the swap match. In any case, the hedge effectiveness will have to be assessed at the reporting date.

	EURIBOR	Fair value of the swap
1 January of year 1	5.00%	0
31 December of year 1	6.57%	4,068,000
31 December of year 2	7.70%	5,793,000
31 December of year 3	6.79%	2,303,000
31 December of year 4	5.76%	241,000

A recognises interest expense based on EURIBOR plus 200 basis points and calculates payments and receipts under the swap at the reporting date as an adjustment to the interest expense. The effect of the two components is a fixed interest rate of 7.5%. The fair value of the swap is recognised as a financial asset or liability with an offsetting amount in equity equal to the effective hedge of the position. The ineffective portion is recognised directly in the profit and loss account.

1 January of year 1

The following entry is made of the conclusion of the loan:

Cash	100,000,000	
Long-term debt		100,000,000

Regarding the fair value of the interest rate swap, no entries need to be made as it was zero at the start of the swap.

31 December of year 1

During the financial year, interest rates increase, resulting in an adjustment of the fair value of the interest rate swap to 4,068,000. The effectiveness of the hedge is assessed at reporting date and the assumption is that the hedge is highly effective.

As ineffectiveness is zero, the change in fair value of the exchange is recognised directly in equity (revaluation reserve). A paid 500,000 due under the swap on 31 December of year 1. The variable interest rate based on EURIBOR for the coming year is 6.57%.

The following entry is made of the change in fair value of the swap (based on cash flow hedge accounting):

Swap	4,068,000	
Equity (revaluation reserve)		4,068,000

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 5% plus 2%) on the “original” loan contract and the payment of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	7,000,000	
Cash		7,000,000
Interest expense	500,000	
Cash		500,000

31 December of year 2

During the financial year, interest rates increase, resulting in an adjustment of the fair value of the interest rate swap to 5,793,000. The effectiveness of the hedge is again assessed at the reporting date and again the hedge is judged to be effective. As ineffectiveness is zero, the change in fair value of the swap is recognised directly in equity (revaluation reserve). A receives 1,070,000 under the interest rate swap at 31 December of year 2. The variable interest rate based on EURIBOR for the coming year is 7.7%.

The following entry is made of the change in fair value of the swap (based on cash flow hedge accounting):

Swap	1,725,000	
Equity (revaluation reserve)		1,725,000

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 6.57% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	8,570,000	
Cash		8,570,000
Cash	1,070,000	
Interest expense		1,070,000

31 December of year 3

During the financial year, interest rates decrease, resulting in an adjustment of the fair value of the interest rate swap to 2,303,000. The ineffectiveness of the hedge is assessed at the reporting date and assumed that it will be zero. As ineffectiveness is zero, the change in fair value of the swap is recognised directly in equity (revaluation reserve). A receives 2,200,000 under the interest rate swap at 31 December of year 3. The variable interest rate based on EURIBOR for the coming year is 6.79%.

The following entry is made of the change in fair value of the swap (based on cash flow hedge accounting):

Equity (revaluation reserve)	3,490,000	
Swap		3,490,000

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 7.7% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	9,700,000	
Cash		9,700,000
Cash	2,200,000	
Interest expense		2,200,000

31 December of year 4

During the financial year, interest rates decrease, resulting in an adjustment of the fair value of the interest rate swap to 241,000. The ineffectiveness of the hedge is assessed at reporting date and assumed that it will be zero. As ineffectiveness is zero, the change in fair value of the swap is recognised in equity (revaluation reserve). A receives 1,290,000 under the interest rate swap at 31 December year 4. The variable interest rate based on EURIBOR for the coming year is 5.76%.

The following entry is made of the fair value of the derivative (based on cash flow hedge accounting):

Equity (revaluation reserve)	2,062,000	
Swap		2,062,000

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 6.79% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	8,790,000	
Cash		8,790,000
Cash	1,290,000	
Interest expense		1,290,000

31 December of year 5

The interest rate swap is terminated on 31 December of year 5. A receives 260,000 under the interest rate swap at 31 December year 5. The following entry is made of the fair value of the derivative (from cash flow hedge accounting):

Equity (revaluation reserve)	241,000	
Swap		241,000

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 5.76% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	7,760,000	
Cash		7,760,000
Cash	260,000	
Interest expense		260,000

Recapitulation

Hedging against a rise in interest rates by entering into the interest rate swap on 1 January of year 1 had the following effect on interest expense:

	Without swap	With swap
Interest expense in year 1	7,000,000	7,500,000
Interest expense in year 2	8,570,000	7,500,000
Interest expense in year 3	9,700,000	7,500,000
Interest expense in year 4	8,790,000	7,500,000
Interest expense in year 5	7,760,000	7,500,000

Example: Cash flow hedge accounting (2) (hedging interest rate risk through interest rate cap)

On 4 January of year 1, company A issues a bond loan for 100 million with variable interest. It pays annual interest at the EURIBOR rate plus a premium of 200 basis points on this bond loan. EURIBOR is revised annually on 31 December.

A wants to hedge against a rise in interest expense on the bond loan by limiting the interest rate rise to a maximum of 9% (EURIBOR at 7% plus 2%). It therefore purchases an interest rate cap indexed to EURIBOR with a notional amount of 100 million. Given this interest rate cap, A is paid the difference between 7% and EURIBOR when EURIBOR exceeds this 7%. The interest rate cap (intrinsic value only) is designated as a hedging instrument for applying cash flow hedge accounting. The objective of the hedge is to reduce the variability of cash flow for the payment of variable interest.

Notional amount:	100 million
Transaction date:	4 January of year 1
Commencement date:	4 January of year 1
End date:	31 December of year 5
Maximum interest under the interest rate cap:	7%
Index:	EURIBOR
EURIBOR when the bond is issued:	5.56%
Premium:	1.44 million

Payments on the interest rate cap are made 12 months after the maturity date. For example, the portion of the interest rate cap maturing on 31 December of year 1 will be paid on 31 December of year 2. The fair value of the interest rate cap throughout the term is:

	EURIBOR	Interest rate cap	Fair value of interest rate cap	Intrinsic value of interest rate cap	Time value of interest rate cap	Payments interest rate cap
4 January of year 1	5.56%	7.00%	1,440,000	-	1,440,000	-
31 December of year 1	5.00%	7.00%	1,000,000	-	1,000,000	-
31 December of year 2	5.50%	7.00%	850,000	-	850,000	-
31 December of year 3	7.50%	7.00%	1,500,000	895,000	605,000	500,000
31 December of year 4	8.00%	7.00%	1,000,000	1,000,000	-	1,000,000

NB Intrinsic value is determined on a discounted basis.

4 January of year 1

A makes the following entry of the bond loan issue:

Cash	100,000,000	
Bond loan		100,000,000

It records the following as regards the purchase of the interest rate cap:

Interest rate cap	1,440,000	
Cash		1,440,000

31 December of year 1

The interest expense on the bond loan for 100 million (EURIBOR 5.56% after revision plus 2%) under the "original" terms are recognised as follows:

Interest expense	7,560,000	
Cash		7,560,000

As for the adjustment to the intrinsic value of the interest rate cap, no entry needs to be made as it is zero. The following entry is made for the fair value change pursuant to the time value of the interest rate cap:

Loss	440,000	
Interest rate cap		440,000

31 December of year 2

The interest expense on the bond loan for 100 million (EURIBOR 5.00% after revision plus 2%) under the "original" terms are recognised as follows:

Interest expense	7,000,000	
Cash		7,000,000

As for the adjustment to the intrinsic value of the interest rate cap, no entry needs to be made as it is zero.

The following entry is made for the fair value change pursuant to the time value of the interest rate cap:

Loss	150,000	
Interest rate cap		150,000

31 December of year 3

The interest expense on the bond loan for 100 million (EURIBOR 5.50% after revision plus 2%) under the "original" terms are recognised as follows:

Interest expense	7,500,000	
Cash		7,500,000

The following entry is made for the fair value change pursuant to the time value of the interest rate cap, recognised in the profit and loss account, and the intrinsic value change, recognised in equity:

Interest rate cap	650,000	
Loss	245,000	
Equity (revaluation reserve)		895,000

31 December of year 4

The interest expense on the bond loan for 100 million (EURIBOR 7.50% after revision plus 2%) under the "original" terms are recognised as follows:

Interest expense	9,500,000	
Cash		9,500,000

The following entry is made for the fair value change pursuant to the time value of the interest rate cap, recognised in the profit and loss account, and the intrinsic value change, recognised in equity: This entry also includes the receipt of interest under the interest rate cap, as the variable interest exceeded the interest under the interest rate cap (i.e. by 0.5% = 7.50% - 7.00%).

Cash	500,000	
Loss	605,000	
Equity (revaluation reserve)		105,000
Interest rate cap		500,000
Interest expense		500,000

31 December of year 5

The borrowing costs on the bond for 100 million (EURIBOR 8.00% after revision plus 2%) under the "original" terms are recognised as follows:

Interest expense	10,000,000	
Cash		10,000,000

The entry shown below is made for the fair value change of the interest rate cap and the intrinsic value change recognised in equity: This entry further includes the receipt of interest under the interest rate cap, as the variable interest exceeded the interest under the interest rate cap (i.e. by 1.00% = 8.00% - 7.00%).

Cash	1,000,000	
Interest expense		1,000,000
Equity (revaluation reserve)	1,000,000	
Interest rate cap		1,000,000

Recapitulation

Hedging against a rise in interest rates by buying the interest rate cap for 1,440,000 (premium) on 4 January of year 1 has the following effect on interest expense:

	Without interest rate cap	**With interest rate cap**
Interest expense in year 1	7,560,000	7,560,000
Interest expense in year 2	7,000,000	7,000,000
Interest expense in year 3	7,500,000	7,500,000
Interest expense in year 4	9,500,000	9,000,000
Interest expense in year 5	10,000,000	9,000,000

Of course, the 1,440,000 investment in the interest rate cap is also charged to profit or loss.

Example: Cash flow hedge accounting (3) (hedge of a currency risk on expected sales through a forward foreign exchange contract)

Company A's functional currency is the euro, but it sells to buyers in the US in US dollars. A would like to hedge its exposure to fluctuations in the current exchange rate by entering into a forward foreign exchange contract under which US dollars are sold and euros are purchased at a fixed rate at a predetermined time that coincides with the expected time of sale.

A can choose to allocate the hedge risk as a change in the current or the forward USD/euro exchange rate. This risk will end when the sale is made and the hedging instrument matures.

If A chooses to hedge against fluctuations in the current exchange rate, the fair value changes in the forward foreign exchange contract due to the changes in the current exchange rate (from period to period) are recognised in equity (for the effective portion of the hedged item). The fair value changes in the forward foreign exchange contract due to forward points adjustments are recognised directly in profit or loss over the term of the hedge.

If A chooses to hedge against fluctuations in the forward exchange rate, the full fair value change in the forward foreign exchange contract is recognised in equity (for the effective portion of the hedged item). Unlike in the case of allocation to the current exchange rate, fair value changes due to forward points adjustments are recognised in equity (rather than in profit or loss) over the term of the hedge.

If the hedge were to be considered fully effective over its entire term, fair value of the forward points would never be recognised in profit or loss (when the hedge and the hedging instrument expire, the fair value of the forward points is zero as there are no more forward points at that point). The fair value of the forward foreign exchange contract at maturity will be equal to the difference between the current exchange rate at maturity and the agreed exchange rate.

Example: Cash flow hedge accounting (4) (hedge of a currency risk from an expected purchase through a forward foreign exchange contract)

On 4 January, company A expects to purchase 100,000 products on about 31 December. This purchase will be from a US supplier, Company B, and is highly probable. A's functional currency is the euro. On 4 January, A designates the expected purchase as the hedged item and enters into a forward foreign exchange contract at USD 180,000 based on the expected USD repurchase (100,000 products x USD 1.8 per product). When the hedge is entered into, the fair value of the forward foreign exchange contract is zero. The terms of the forward foreign exchange contract and the expected purchase match. A designates the currency risk of the expected purchase as the hedged item. Potential sources of ineffectiveness are the purchase not being made and changes in the date of purchase.

At 30 June, the fair value of the forward foreign exchange contract is EUR 10,000 positive. This is due to the strengthening of the USD against the euro. On 31 December, the transaction takes place as expected. The fair value of the forward foreign exchange contract is then EUR 12,500 positive.

The entries to be made are shown below.

4 January

The fair value of the derivative is zero, meaning that no entry is made. However, any transaction costs are recognised.

30 June

Recognition of the fair value increase (in EUR):

Forward foreign exchange contract	10,000	
Equity (revaluation reserve)		10,000

The change in fair value is recognised entirely in equity, as the hedge is fully effective.

31 December

Recognition of the fair value increase (in EUR):

Forward foreign exchange contract	2,500	
Equity (revaluation reserve)		2,500

The change in fair value is recognised entirely in equity, as the hedge is fully effective.

Recognition of the forward foreign exchange contract settlement (in EUR):

Bank	12,500	
Forward foreign exchange contract		12,500

Recognition of USD 180,000 payment for the purchase of 100,000 products at the conversion rate of USD 1.6 : EUR 1 (in EUR):

Inventory	112,500	
Bank		112,500

Transfer to inventory of hedging instrument gain recognised directly in equity (in EUR):

Equity (revaluation reserve)	12,500	
Inventory		12,500

A recognises the gain on the foreign exchange forward contract as an adjustment to the initial carrying amount for the inventory (basis adjustment; DAS 290.631). The reason for this is that the hedged item results in recognition of a non-financial asset (inventory), which requires basis adjustment. Under this method, the associated hedge gains or losses are recognised in the initial measurement of inventory and are ultimately recognised as cost of sales in the profit and loss account. The net effect of this recognition method is that the inventory is measured based on the exchange rate in the forward foreign exchange contract, thereby achieving the desired matching.

Translation of the purchase at the current exchange rate at 31 December	EUR 112,500
Transfer from equity to inventory at 31 December (basis adjustment)	EUR (12.500)
Initial measurement of inventory	EUR 100,000

Example: Cash flow hedge accounting (5) (hedge of price risk on precious metal purchases through a futures contract)

Company A signs a call-off contract on 1 January to purchase 10 kg of precious metals, to be delivered on 1 June. A cannot renege on the call-off contract.

A also buys a futures contract for the purchase of 10 kg of precious metals at EUR 10 on June 1. The premium is EUR 500, while the market value of the futures contract at the time of purchase is zero. The objective of the futures contract is to fix the price of the inventory.

Between January and June, the price of the precious metals falls to EUR 9 and remains at this level until the futures contract matures. For the sake of simplicity, we assume that futures contract has a negative market value of EUR 10,000 from the time of depreciation and that no amounts need to be remitted to clearing organisations in the interim.

The recognition method is then as follows (in EUR):

Initial measurement at 1 January (in EUR):

Futures contract	500	
Bank		500

Although the market value of the futures contract is zero, transaction costs are included in the initial measurement of the future.

The interim change in value of the futures contract is recognised as follows (in EUR):

Equity (revaluation reserve)	10,500	
Futures contract		10,500

On balance, the futures contract is now on the balance sheet at the negative market value of EUR 10,000. The transaction costs are also "submerged" in equity (negative revaluation reserve).

The settlement of the futures contract is recognised as follows (in EUR):

Futures contract	10,000	
Bank		10,000

The bank acts as a clearing organisation. In the case of futures contract, it is common for interim payments to be required in order to reduce the credit risk for the receiving party.
The receipt of the precious metals is recognised as follows (in EUR):

Inventory	90,000	
Accounts payable		90,000

Purchase of the precious metal at a price in line with the market price of EUR 9.

The basis adjustment (DAS 290.631) due to the release of the loss on the futures contract is recognised as follows: (in EUR):

Inventory	10,500	
Equity (revaluation reserve)		10,500

This entry leaves the inventory measured at EUR 10 (including EUR 500 transaction costs), in line with A's objective of fixing the price.

The final gain on the futures contract is generated on the sale of the precious metals inventory, For example, on 15 June, the inventory is sold at EUR 11. The entry for this is as follows (in EUR):

Accounts receivable	110,000	
Inventory		100,500
Gain on the futures contract (profit and loss account)		9,500

Without the futures contract, the value of the inventory at market price would have been EUR 90,000, making a profit of EUR 20,000 (= EUR 110,000 – EUR 90,000). By entering into the futures contract, A has incurred a loss of EUR 10,500 (including transaction costs).

1.3 Examples of cost hedge accounting

Example: Cost hedge accounting (1) (hedge of interest rate risk through interest rate swap)

Company A takes out a loan of 100 million with a variable interest rate and a five-year term on 1 January of year 1. The floating rate on the loan is EURIBOR plus 200 basis points. EURIBOR at the start of the loan is 5%. Interest on the loan is calculated on an annual basis and is revised annually on 31 December based on EURIBOR.

On 1 January of year 1, A enters into an interest rate swap with a notional amount of 100 million, the agreement being that A will receive a fixed interest rate in exchange for the EURIBOR interest rate for five years. The swap is designed to hedge the risk of variability in the interest cash flow payable. The interest rate swap is put on the market at the start of the loan and its fair value at that point is zero.

Notional amount:	100 million
Transaction date:	1 January of year 1
Commencement date:	1 January of year 1
Expiry date:	31 December of year 5
Company A pays:	5.5% interest per annum
Company A receives:	EURIBOR
Payment and receipt dates:	annually at the repayment dates
Review of floating rate (EURIBOR):	annually at 31 December
First date of payment and receipt:	31 December of year 1
Last date of payment and receipt:	31 December of year 5

The interest rate swap is considered highly effective because the terms of the loan and the swap match. In any case, the hedge effectiveness will have to be assessed at the reporting date.

	EURIBOR	Fair value of the swap
1 January of year 1	5.00%	0
31 December of year 1	6.57%	4,068,000
31 December of year 2	7.70%	5,793,000
31 December of year 3	6.79%	2,303,000
31 December of year 4	5.76%	241,000

A recognises interest expense based on EURIBOR plus 200 basis points and calculates payments and receipts under the swap at the reporting date as an adjustment to the interest expense. The effect of the two components is a fixed interest rate of 7.5%. Because A applies cost hedge accounting, the swap is measured at cost. An ineffective portion should be recognised immediately in the profit and loss account if and to the extent that it is cumulatively a loss. In that case, a liability is recognised on the balance sheet in the amount of that cumulative loss.

1 January of year 1

The following entry is made of the conclusion of the loan:

Cash	100,000,000	
Long-term debt		100,000,000

Regarding the interest rate swap, no entries need to be made as the cost is zero.

31 December of year 1

During the financial year, interest rates increase, resulting in an adjustment of the fair value of the interest rate swap to 4,068,000. The effectiveness of the hedge is assessed at reporting date and the assumption is that the hedge is highly effective. A pays 500,000 due under the swap on 31 December of year 1. The variable interest rate based on EURIBOR for the coming year is 6.57%.

As cost hedge accounting is applied, the increase in the fair value of the interest rate swap is not recognised. The fact is that the interest rate swap is measured at cost.

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 5% plus 2%) on the "original" loan contract and the payment of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	7,000,000	
Cash		7,000,000
Interest expense	500,000	
Cash		500,000

31 December of year 2

During the financial year, interest rates increase, resulting in an adjustment of the fair value of the interest rate swap to 5,793,000. The effectiveness of the hedge is again assessed at the reporting date and again the hedge is judged to be effective. A receives 1,070,000 under the interest rate swap at 31 December of year 2. The variable interest rate based on EURIBOR for the coming year is 7.7%.

As cost hedge accounting is applied, the increase in fair value of the interest rate swap is not recognised. The fact is that the interest rate swap is measured at cost.

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 6.57% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	8,570,000	
Cash		8,570,000
Cash	1,070,000	
Interest expense		1,070,000

31 December of year 3

During the financial year, interest rates decrease, resulting in an adjustment of the fair value of the interest rate swap to 2,303,000. The ineffectiveness of the hedge is assessed at the reporting date and assumed that it will be zero. A receives 2,200,000 under the interest rate swap at 31 December of year 3. The variable interest rate based on EURIBOR for the coming year is 6.79%.

As cost hedge accounting is applied, the decrease in fair value of the interest rate swap is not recognised. The fact is that the interest rate swap is measured at cost.

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 7.7% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	9,700,000	
Cash		9,700,000
Cash	2,200,000	
Interest expense		2,200,000

31 December of year 4

During the financial year, interest rates decrease, resulting in an adjustment of the fair value of the interest rate swap to 241,000. The ineffectiveness of the hedge is assessed at reporting date and assumed that it will be zero. A receives 1,290,000 under the interest rate swap at 31 December year 4. The variable interest rate based on EURIBOR for the coming year is 5.76%.

As cost hedge accounting is applied, the increase in fair value of the interest rate swap is not recognised. The fact is that the interest rate swap is measured at cost.

The following entry is made of the interest payment (EURIBOR plus 200 basis points, 6.79% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	8,790,000	
Cash		8,790,000
Cash	1,290,000	
Interest expense		1,290,000

31 December of year 5

The interest rate swap is terminated on 31 December of year 5. A receives 260,000 under the interest rate swap at 31 December year 5. The following entry is made of the interest payment (EURIBOR plus 200 basis points, 5.76% plus 2%) on the "original" loan contract and the receipt of the interest rate adjustment under the swap (effectively 7.5%):

Interest expense	7,760,000	
Cash		7,760,000
Cash	260,000	
Interest expense		260,000

Recapitulation

Hedging against a rise in interest rates by entering into the interest rate swap on 1 January of year 1 had the following effect on interest expense:

	Without swap	With swap
Interest expense in year 1	7,000,000	7,500,000
Interest expense in year 2	8,570,000	7,500,000
Interest expense in year 3	9,700,000	7,500,000
Interest expense in year 4	8,790,000	7,500,000
Interest expense in year 5	7,760,000	7,500,000

Example: Cost hedge accounting (2) (hedge of interest rate risk through an interest rate cap)

On 4 January of year 1, company A issues a bond loan for 100 million with variable interest. It pays annual interest at the EURIBOR rate plus a premium of 200 basis points on this bond loan. EURIBOR is revised annually on 31 December.

A wants to hedge against a rise in interest expense on the bond loan by limiting the interest rate rise to a maximum of 9% (EURIBOR at 7% plus 2%). It therefore purchases an interest rate cap indexed to EURIBOR with a notional amount of 100 million. Given this interest rate cap, A is paid the difference between 7% and EURIBOR when EURIBOR exceeds this 7%.

The interest rate cap (intrinsic value only) is designated as a hedging instrument for applying cash flow hedge accounting. The objective of the hedge is to reduce the variability of cash flow for the payment of variable interest.

Notional amount:	100 million
Transaction date:	4 January of year 1
Commencement date:	4 January of year 1
End date:	31 December of year 5
Maximum interest under the interest rate cap:	7%
Index:	EURIBOR
EURIBOR when the bond is issued:	5.56%
Premium:	1.44 million

Payments on the interest rate cap are made 12 months after the maturity date. For example, the portion of the interest rate cap maturing on 31 December of year 1 will be paid on 31 December year 2. The fair value of the interest rate cap throughout the term is:

	EURIBOR	Interest rate cap	Fair value of interest rate cap	Intrinsic value of interest rate cap	Time value of interest rate cap	Interest rate cap payments
4 January of year 1	5.56%	7.00%	1,440,000	-	1,440,000	-
31 December of year 1	5.00%	7.00%	1,000,000	-	1,000,000	-
31 December of year 2	5.50%	7.00%	850,000	-	850,000	-
31 December of year 3	7.50%	7.00%	1,500,000	895,000	605,000	500,000
31 December of year 4	8.00%	7.00%	1,000,000	1,000,000	-	1,000,000

NB Intrinsic value is determined on a discounted basis.

4 January of year 1

A makes the following entry of the bond loan issue:

Cash	100,000,000	
Bond loan		100,000,000

31 December of year 1

The interest expense on the bond loan for 100 million (EURIBOR 5.56% after revision plus 2%) under the "original" terms are recognised as follows:

Interest expense Cash	7,560,000	 7,560,000
Amortisation of the interest rate cap is recognised as follows (based on straight-line amortisation):		
Interest expense Interest rate cap	288,000	 288,000
31 December of year 2 The interest expense on the bond loan for 100 million (EURIBOR 5.00% after revision plus 2%) under the "original" terms are recognised as follows:		
Interest expense Cash	7,000,000	 7,000,000
Amortisation of the interest rate cap is recognised as follows (based on straight-line amortisation):		
Interest expense Interest rate cap	288,000	 288,000
31 December of year 3 The interest expense on the bond loan for 100 million (EURIBOR 5.50% after revision plus 2%) under the "original" terms are recognised as follows:		
Interest expense Cash	7,500,000	 7,500,000
Amortisation of the interest rate cap is recognised as follows (based on straight-line amortisation):		
Interest expense Interest rate cap	288,000	 288,000
31 December of year 4 The interest expense on the bond loan for 100 million (EURIBOR 7.50% after revision plus 2%) under the "original" terms are recognised as follows:		
Interest expense Cash	9,500,000	 9,500,000
Given that the variable interest exceeds the interest under the interest rate cap (by 0.5% = 7.50% - 7.00%), the receipt of interest under the interest rate cap is recognised as follows:		
Cash Interest expense	500,000	 500,000
Amortisation of the interest rate cap is recognised as follows (based on straight-line amortisation):		
Interest expense Interest rate cap	288,000	 288,000
31 December of year 5 The interest expense on the bond loan for 100 million (EURIBOR 8.00% after revision plus 2%) under the "original" terms are recognised as follows:		
Interest expense Cash	10,000,000	 10,000,000

Given that the variable interest exceeds the interest under the interest rate cap (by 1,00% = 8,00% - 7.00%), the receipt of interest under the interest rate cap is recognised as follows:

Cash	1,000,000	
Interest expense		1,000,000

Amortisation of the interest rate cap is recognised as follows (based on straight-line amortisation):

Interest expense	288,000	
Interest rate cap		288,000

Recapitulation

Hedging against a rise in interest rates by buying the interest rate cap for 1,440,000 (premium) on 4 January of year 1 has the following effect on interest expense:

	Without interest rate cap	**With interest rate cap (including amortisation premium)**	**With interest rate cap (excluding amortisation premium)**
Interest expense in year 1	7,560,000	7,848,000	7,560,000
Interest expense in year 2	7,000,000	7,288,000	7,000,000
Interest expense in year 3	7,500,000	7,788,000	7,500,000
Interest expense in year 4	9,500,000	9,288,000	9,000,000
Interest expense in year 5	10,000,000	9,288,000	9,000,000

The 1,440,000 investment in the interest rate cap is also charged to profit or loss through straight-line amortisation (288,000 per annum). The Dutch Accounting Standards Board allows straight-line amortisation instead of applying the effective interest method as an alternative if straight-line amortisation does not result in significant differences compared to the effective interest method (DAS 290.0 under the definition of amortised cost).

Example: Cost hedge accounting (3) (hedge of currency risk from expected sales through a forward foreign exchange contract)

On 1 December of year 1, a company enters into a forward foreign exchange contract to sell USD 1 million in exchange for euro at a fixed rate of USD 1 = EUR 0.637 on 31 January of year 2. The company's financial year ends on 31 December and its functional currency is the euro. The forward contract was entered into to hedge the currency risk caused by changes in the current exchange rate. The currency risk relates to an expected sale at the end of January year 2. The revenue of this expected sale is expected to be USD 1 million, so the hedged item is not yet recognised on the balance sheet.

Forward and current rates (USD / EUR) are as follows:

	1 December of year 1	**31 December of year 1**	**31 January of year 2**
Current rate	0.645	0.629	0.621
Forward rate (31 January of year 2)	0.637	0.625	N/A

On 31 January of year 2, A settles the forward foreign exchange contract and receives USD 1 million from the sale transaction. Translating USD 1 million at the above rates gives the following amounts in euros:

	1 December of year 1	**31 December of year 1**	**31 January of year 2**
Current rate	0.645	0.629	0.621
Amount	EUR 645,000	EUR 629,000	EUR 621,000
Forward rate (31 January of year 2)	0.637	0.625	N/A
Amount	EUR 637,000	EUR 625,000	

The fair value, intrinsic value and forward points of the forward foreign exchange contract are as follows:

	Fair value (intrinsic value + forward points)	Intrinsic value (forward rate contract - current rate on date)	Value of forward points (current rate on date - forward rate on date)
1 December of year 1	0	EUR (8,000) (= EUR 637,000 - EUR 645,000)	EUR 8,000 (= EUR 645,000 - EUR 637,000)
31 December of year 1	EUR 12,000 (= EUR 8,000 + EUR 4,000)	EUR 8,000 (= EUR 637,000 – EUR 629,000)	EUR 4,000 (= EUR 629,000 – EUR 625,000)
31 January of year 2	EUR 16,000 (= EUR 16,000 + EUR 0)	EUR 16,000 (= EUR 637,000 - EUR 621,000)	0

The following entries are made:

1 December of year 1

The cost of the forward contract is zero. This is the balance of the value of the forward points (EUR 8,000 positive) and the intrinsic value (EUR 8,000 negative). If cost hedge accounting is applied, the forward contract is recognised at cost. Since the cost is zero, no entry is made.

31 December of year 1

If cost hedge accounting is applied to hedged items not yet recognised on the balance sheet, the forward contract continues to be recognised at cost. The condition for this is that the hedge is still effective. The result is that no entry is made.

31 January of year 2

The next entry is made of the sale transaction:

Bank	EUR 621,000	
Revenue		EUR 621,000

The payment made to settle the forward contract is recognised as follows:

Bank	EUR 16,000	
Gain on the forward contract (profit or loss)		EUR 16,000

The exchange loss on the USD 1 million received is recognised as part of revenue (EUR 24,000). According to DAS 290.637, the gain on the forward contract is recognised in profit or loss at the same time as this loss is recognised (EUR 16,000). This EUR 16,000 gain on the forward contract is the balance of the exchange gain of EUR 24,000 on the forward contract and the forward points value of EUR 8,000. The value of the forward points is in fact the hedging costs that are also ultimately charged to profit or loss. As a result, matching has been achieved between the exchange gains and losses on the hedged item (EUR 24,000 negative) and the exchange gains and losses on the forward contract (EUR 24,000 positive) and the forward points have been charged to profit or loss at the same time as the sale transaction is recognised (as hedging costs). The forward points are not allocated to the period of the forward contract. This is because the forward contract is not remeasured (and therefore remains measured at zero) as long as the hedged item is not yet recognised on the balance sheet (DAS 290.633). Incidentally, the gain or loss on the forward contract can be recognised as part of revenue.

Example: Cost hedge accounting (4) (hedge of currency risk from expected sales through a forward foreign exchange contract)

On 1 December of year 1, a company enters into a forward foreign exchange contract to sell USD 1 million in exchange for euro at a fixed rate of USD 1 = EUR 0.637 on 31 January of year 2. The company's financial year ends on 31 December and its functional currency is the euro. The forward foreign exchange contract is entered into to hedge the currency risk caused by changes in the current exchange rate over the period from 1 December of year 1 to 31 January year 2. The currency risk relates to an expected sale at the end of December of year 1 that is expected to result in the receipt of USD 1 million at the end of January year 2. The sale transaction takes place at the end of December of year 1 and is recognised on the balance sheet at that time.

The trend in foreign exchange rates is the same as in the previous example.

The following entries are made:

1 December of year 1

The cost of the forward foreign exchange contract is zero. This is the balance of the value of the forward points (EUR 8,000 positive) and the intrinsic value (EUR 8,000 negative). If cost hedge accounting is applied, the forward contract is recognised at cost. Since the cost is zero, no entry is made.

31 December of year 1

The transaction is recognised at the transaction rate on the transaction date (i.e. the then current rate):

Accounts receivable	EUR 629,000	
Revenue		EUR 629,000

If the hedged item is a foreign currency monetary item and is recognised on the balance sheet, the derivative is also revalued and recognised at its fair value at that time (DAS 290.637):

Forward foreign exchange contract	EUR 12,000	
Gain on the forward foreign exchange contract (profit or loss)		EUR 12,000

The gain or loss on the forward foreign exchange contract can also be recognised as part of revenue.

31 January of year 2

At 31 January of year 2, the USD receivable is translated at the current rate on the reporting date. The exchange loss compared to 31 December of year 1 is recognised as follows:

Exchange gains and losses (profit or loss)	EUR 8,000	
Receivable		EUR 8,000

The currency element in the forward foreign exchange contract measured at cost is also measured at the current exchange rate at the reporting date. The exchange gain compared to 31 December of year 1 is recognised as follows:

Forward foreign exchange contract (intrinsic value)	EUR 8,000	
Gains and losses on the forward foreign exchange contract (profit or loss)		EUR 8,000

The allocation of forward points to the period from 1 January of year 2 to 31 January of year 2 is recognised as follows:

Interest expense (= EUR 4,000 - 0)	EUR 4,000	
Forward foreign exchange contract (value of forward points)		EUR 4,000

On the balance sheet at 31 January of year 2, the forward foreign exchange contract is measured at its fair value of EUR 16,000 at that date. This represents the balance of the recognised movements in intrinsic value and the recognised movements in the value of forward points (= 12,000 + 8,000 - 4,000).

The receipt of the receivable is then recognised:

Bank	EUR 621,000	
Receivable		EUR 621,000

The payment made to settle the forward foreign exchange contract is recognised as follows:

Bank	EUR 16,000	
Forward foreign exchange contract		EUR 16,000

The exchange loss on the receivable of USD 1 million (EUR 8,000) is recognised in the profit and loss account. The exchange gain on the forward foreign exchange contract is recognised in the profit and loss account at the same time as the exchange loss on the receivable (EUR 8,000). As a result, matching is achieved between the exchange gains and losses on the USD receivable and the exchange gains and losses on the forward foreign exchange contract. In addition, the forward points recognised on the balance sheet at year-end 1 are capitalised as part of the fair value of the forward foreign exchange contract attributed to the period that the hedged item is recognised on the balance sheet (EUR 4,000).

Example: Cost hedge accounting (5) (hedge of currency risk on monetary item in balance sheet through a forward foreign exchange contract)

On 1 December of year 1, a company enters into a forward foreign exchange contract to hedge a balance sheet receivable of USD 1 million. Under the forward foreign exchange contract, USD 1 million is to be sold in exchange for euros at a fixed rate of USD 1 = EUR 0.637 on 31 January of year 2. The company expects to collect the receivable on 31 January of year 2. The company's financial year ends on 31 December and its functional currency is the euro. The forward foreign exchange contract is entered into to hedge the currency risk caused by changes in the current exchange rate. The hedged item is thus a foreign currency monetary item recognised on the balance sheet.

The trend in foreign exchange rates is the same as in the previous example.

The following entries are made:

1 December of year 1

The cost of the forward foreign exchange contract is zero. This is the balance of the value of the forward points (EUR 8,000 positive) and the intrinsic value (EUR 8,000 negative).

When applying cost hedge accounting where the hedged item is a foreign currency monetary balance sheet item, the forward points are allocated to the period of the forward contract. These forward points are mainly due to interest rate differentials and can be considered as hedging costs. This provision is included in a.3 of DAS 290.633.

In fact, to make these entries, the following entry is made when the forward contract is entered into:

Value of forward points (B)	EUR 8,000	
Intrinsic value of the forward foreign exchange contract (B)		EUR 8,000

On balance, this recognises a cost on the balance sheet of zero, as these amounts are netted on the balance sheet.

31 December of year 1

At the end of the financial year, the USD receivable is translated at the current exchange rate on the reporting date. The exchange loss compared to 1 December of year 1 is recognised as follows:

Exchange gains and losses (profit or loss)	EUR 16,000	
Receivable		EUR 16,000

The currency element in the forward foreign exchange contract measured at cost is also measured at the current exchange rate at the reporting date. The change in the intrinsic value of the forward foreign exchange contract compared to 1 December of year 1 is recognised as follows:

Intrinsic value of the forward foreign exchange contract (B)	EUR 16,000	
Exchange gains and losses (profit or loss)		EUR 16,000

The allocation of forward points to the period from 1 December of year 1 to 31 December of year 1 is recognised as follows:

Interest expense (profit or loss) (= EUR 8,000 - EUR 4,000)	EUR 4,000	
Value of forward points (B)		EUR 4,000

On the balance sheet at 31 December year 1, on balance, the forward contract is measured at EUR 12,000 (= EUR 16,000 - EUR 4,000).

31 January of year 2

At 31 January of year 2, the USD receivable is translated at the current rate on the reporting date. The exchange loss compared to 31 December of year 1 is recognised as follows:

Exchange gains and losses (profit or loss)	EUR 8,000	
Receivable		EUR 8,000

The currency element in the forward foreign exchange contract measured at cost is also measured at the current exchange rate at the reporting date. The change in the intrinsic value of the forward foreign exchange contract compared to 31 December year 1 is accounted for as follows:

Intrinsic value of the forward foreign exchange contract (B)	EUR 8,000	
Exchange gains and losses (profit or loss)		EUR 8,000

The allocation of forward points to the period from 1 January of year 2 to 31 January of year 2 is recognised as follows:

Interest expense (profit or loss) (= EUR 4,000 - 0)	EUR 4,000	
Value of forward points (B)		EUR 4,000

On the balance sheet at 31 January year 2, the forward foreign exchange contract is measured at EUR 16,000 (= 8,000 - 8,000 + 16,000 - 4,000 + 8,000 - 4,000). This is the balance of the movements recognised in intrinsic value and the movements recognised in the value of the forward points.

The receipt of the receivable is then recognised:

Bank	EUR 621,000	
Receivable		EUR 621,000

The payment made to settle the forward foreign exchange contract is recognised as follows:

Bank	EUR 16,000	
Intrinsic value of the forward foreign exchange contract (B)		EUR 16,000

The exchange loss on the receivable of USD 1 million (EUR 24,000) is recognised in the profit and loss account. The gain on the derivative is recognised in the profit and loss account at the same time as the exchange loss on the receivable (EUR 24,000). As a result, matching is achieved between the exchange gains and losses on the USD receivable and the movement in the intrinsic value of the forward foreign exchange contract. Hedging costs in the form of forward points are charged to profit or loss for the period from 1 December of year 1 to 31 January of year 2.

Example: Cost hedge accounting (6) (hedge of currency risk on expected purchase through a forward foreign exchange contract)

On 4 January, company A expects to purchase 100,000 products on about 31 December. This purchase will be from a US supplier, Company B, and is highly probable. A's functional currency is the euro. On 4 January, A designates the expected purchase as the hedged item and enters into a forward foreign exchange contract at USD 180,000 based on the expected purchase in USD (100,000 products x USD 1.8 per product). When the hedge is entered into, the fair value of the forward foreign exchange contract is zero. The terms of the forward foreign exchange contract and the expected purchase match. A designates the currency risk of the expected purchase as the hedged item. Potential sources of ineffectiveness are the purchase not being made and changes in the date of purchase.

At 30 June, the fair value of the forward foreign exchange contract is EUR 10,000 positive. This is due to the strengthening of the USD against the euro. On 31 December, the transaction takes place as expected. The fair value of the forward foreign exchange contract is then EUR 12,500 positive.

The entries to be made are shown below.

4 January

The fair value of the derivative is zero, meaning that no entry is made. The fact is that the derivative is recognised at cost. However, any transaction costs are recognised.

30 June

The increase in value of the forward foreign exchange contract is not recognised because the derivative is measured at cost.

31 December

Recognition of the USD 180,000 payment for the purchase of 100,000 products translated at the rate of USD 1.6 : EUR 1 (in EUR):

Inventory	112,500	
Bank		112,500

Recognition of the foreign exchange forward contract settlement (in EUR):

Bank	12,500	
Inventory		12,500

A recognises the gain on the forward foreign exchange contract as an adjustment to the initial carrying amount of the inventory as should be the case if cash flow hedge accounting had been applied (basis adjustment; DAS 290.638). The reason for this is that the hedged item results in recognition of a non-financial asset (inventory), which requires basis adjustment. Under this method, the associated hedge gains and losses are recognised in the initial measurement of inventory and are ultimately recognised as cost of sales in the profit and loss account.

The net effect of this recognition method is that the inventory is measured based on the exchange rate in the forward foreign exchange contract, thereby achieving the desired matching.

Translation of the purchase at the current exchange rate at 31 December	EUR 112.500
Recognition of the gains and losses on the derivative in inventory at 31 December (basis adjustment)	EUR (12.500)
Initial measurement of inventory	EUR 100,000

1.4 Examples of hedges of a net investment in a foreign operation

Example: Hedge of a net investment in a foreign operation (hedge of a currency risk through a forward foreign exchange contract)

On 1 November of year 1, company A enters into a forward foreign exchange contract to sell USD 1,000,000 in exchange for euros at a fixed rate of USD 1.35 = EUR 1 on 30 January of year 2. A's financial year ends on 31 December and its functional currency is the euro. The forward foreign exchange contract is entered into to hedge the currency risk caused by changes in the current exchange rate. The currency risk is due to the participating interest A holds in a US entity, which was previously acquired for USD 1,000,000. A expects its participating interest to be sold on 30 January of year 2.

Forward rates and current rates (EUR/USD) are as follows:

	1 November of year 1	31 December of year 1	30 January of year 2
Current rate	1.33	1.37	1.39
Forward rate (30 January of year 2)	1.35	1.38	N/A

On 30 January of year 2, A settles the forward foreign exchange contract and sells its US participating interest for USD 1,200,000. Translation of USD 1,000,000 at the above rates gives the following amounts in euros:

	1 November of year 1	31 December of year 1	30 January of year 2
Current rate	1.33	1.37	1.39
Amount	EUR 751,880	EUR 729,927	EUR 719,424
Forward rate (30 January of year 2)	1.35	1.38	N/A
Amount	EUR 740,741	EUR 724,638	

The fair value of the derivative at 30 January of year 2 is EUR 21,317 (= EUR 740,741 - EUR 719,424). The change in the value of the forward foreign exchange contract (derivative), excluding the change in the value of the forward points is:

	Change in value of the derivative due to change in current exchange rate	
31 December of year 1	EUR 16,103	(= EUR 740,741 - EUR 724,638)
30 January of year 2	EUR 5,214	(= EUR 724,638 - EUR 719,424)
	EUR 21,317	

Changes in fair value due to the interest rate element (value of forward points) do not give rise to a claim that the hedge is ineffective because the hedged risk is confined to changes in the current exchange rate. Changes in the fair value of forward foreign exchange contracts due to changes in interest rates on the forward rate (value of forward points) are excluded from hedge accounting here (the change in the value of the forward points is due to the hedging costs charged to profit or loss for the period from 1 November of year 1 to 30 January of year 2). These changes cause volatility in the profit and loss account.

	Fair value of the derivative	Intrinsic value (forward rate contract - current rate on date)	Value of forward points (current rate on date - forward price on date)
1 November of year 1	-	EUR (11,139) (= EUR 740,741 - EUR 751,880)	EUR 11,139 (= EUR 751,880 - EUR 740,741)
31 December of year 1	EUR 16,103	EUR 10,814 (= EUR 740,741 - EUR 729,927)	EUR 5,289 (= EUR 729,927 - EUR 724,638)
30 January of year 2	EUR 21,317 EUR 16,103 EUR + 5,214)	EUR 21,317 (= EUR 740,741 - EUR 719,424)	-

The following entries are made:

31 December of year 1

The participating interest is translated at the current closing rate. The exchange difference from the translation of the value of the participating interest for the period from 1 November to 31 December of year 1 is recognised as follows:

Equity (foreign currency translation reserve) (= EUR 751,880 - EUR 729,927)	EUR 21,953	
Participating interest		EUR 21,953

To properly recognise the fair value of the derivative, the effective portion of the hedge is recognised in the foreign currency translation reserve and the ineffective portion in the profit and loss account. The following entry is made:

Derivative	EUR 16,103	
Interest expense (= EUR 11,139 - EUR 5,289)	EUR 5,850	
Equity (foreign currency translation reserve)		EUR 21,953

30 January of year 2

The exchange difference from the translation of the value of the participating interest at the current rate is recognised as follows:

Equity (foreign currency translation reserve) (= EUR 729,927 - EUR 719,424)	EUR 10,503	
Participating interest		EUR 10,503

To properly recognise the fair value of the derivative, the effective portion of the hedge is recognised in the foreign currency translation reserve and the ineffective portion in the profit and loss account. The following entry is made:

Derivative	EUR 5,214	
Interest expense (profit or loss) (= EUR 5,289 - 0)	EUR 5,289	
Equity (foreign currency translation reserve)		EUR 10,503

The payment for settling the derivative is recognised as follows:

Cash	EUR 21,317	
Derivative		EUR 21,317

The gain on the disposal of the US participating interest may be specified as follows:

Sale price	USD 1,200,000
Purchase price	USD 1,000,000
	USD 200,000

The profit on the sale is EUR 143,885 (= USD 200,000 / 1.39). The sale of the US participating interest is recognised as follows:		
Cash (= USD 1,200,000 / 1.39)	EUR 863,309	
Profit from participating interest		EUR 143,885
Participating interest (= USD 1,000,000 / 1.39)		EUR 719,424
The following entry is made of the release of cumulative exchange gains and losses from the participating interest recognised under equity in the foreign currency translation reserve:		
Exchange gains and losses (profit or loss)	EUR 32,456	
Equity (foreign translation differences reserve) (= EUR 21,953 + EUR 10,503)		EUR 32,456
The following entry is made of the release of cumulative exchange gains and losses on the derivative recognised in equity in the foreign currency translation reserve:		
Equity (foreign currency translation reserve) (= EUR 21,953 + EUR 10,503)	EUR 32,456	
Exchange gains and losses (profit or loss)		EUR 32,456

22 Leases

22.1 Introduction

Definitions
A lease occurs when, in a contract between two parties, the lessor cedes the right to use an asset (the lease object) to the lessee for an agreed period and fee. DAS 292 sets out the reporting requirements relating to leases. These reporting requirements apply to all rental, leasehold, ground lease, lease-to-buy and lease contracts. DAS 292 also applies to contracts that transfer the rights to use assets, even though substantial services may be required from the lessor for the use and maintenance of these assets (DAS 292.101).

DAS 292 does not apply to (DAS 292.101):

- lease contracts for the exploration or use of natural resources, such as oil, gas, metals and other mineral rights;
- licence agreements relating to films, videos, plays, manuscripts, patents and copyrights;
- service agreements under which there is no transfer of the right to use assets;
- the recognition of property held by lessees that is recognised as investment property (reference is made to DAS 213 'Investment property'; see Chapter 8 on investment property); and
- investment property made available by lessors through an operating lease (reference is made to DAS 213 'Investment property'; see Chapter 8 on investment property).

Application of IFRS
DAS 292.101 includes the option to apply the provisions of IFRS 16 'Leases' as applicable under IFRS, instead of the provisions of DAS 292, for the recognition of leases in the financial statements. The condition imposed on this is that there must be a comprehensive (i.e. including the disclosure requirements) and consistent application of IFRS 16. If IFRS 16 has been applied, this must be disclosed in the notes. In short, IFRS 16 means that all leases must be recognised on the balance sheet by lessees, with the exception of leases with a lease term of up to 12 months (short-term leases) and leases where the lease object has a low new value (low-value leases). Under DAS 292, lessees only recognise finance leases on the balance sheet.

22.2 Assessing whether a contract contains a lease

General
A contract contains a lease if it grants control over the use of an identified asset to the legal entity (the customer) in exchange for a fee to the other party (the supplier) during the agreed period of use (DAS 292.105). This is the case if all the following conditions are met (DAS 292.105):

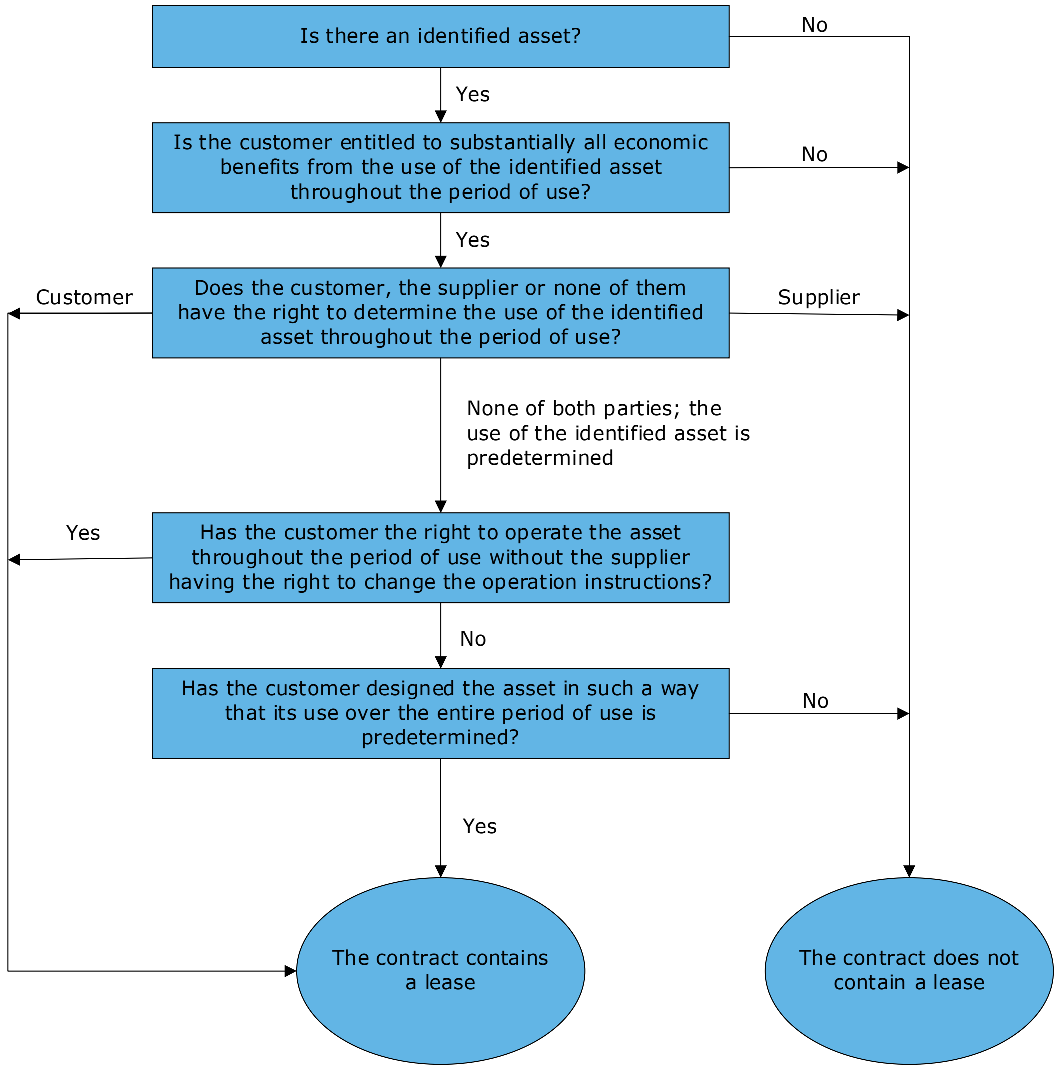
- there is an identified asset;
- the customer is entitled to almost all economic benefits from the use of the identified asset throughout the period of use; and
- the customer has the right to determine the use of the identified asset throughout the period of use.

The last two conditions pertain to control over the use of the identified asset.

Purchase agreements fall beyond the scope of this assessment.

The following diagram outlines a more detailed elaboration of these conditions.

Schedule: Assessing whether a contract contains a lease (DAS 292.105)



Identified asset
The asset is usually identified by the fact that the contract explicitly specifies it. The asset can also be identified when the supplier makes it available for use (DAS 292.106).

If the supplier has the substantial right to replace the asset throughout the period of use, there is no identified asset and therefore no lease. This is the case only if both of the following conditions are met (DAS 292.106a):

- in practice, the supplier has the option of replacing the asset with an alternative asset throughout the period of use. For example, the customer cannot prevent the supplier from replacing the asset and alternative assets are readily available to the supplier or could possibly be provided by the supplier within a reasonable time; and
- the supplier has an economic advantage in exercising its right to replace the asset. That is, the economic benefits of replacing the asset exceed the cost of replacing the asset. In doing so, the costs associated with replacement are generally higher if the asset is located in a building or on the premises of the customer or elsewhere than if the asset is located in a building or on the premises of the supplier.

Part of an asset's capacity is an identified asset if it is physically separated (e.g. the floor of a building). Part of the capacity or other part of an asset that is not physically separated (e.g. part of the capacity of a fibre-optic cable) is not an identified asset, unless it represents substantially all of the asset's capacity and therefore the customer is entitled to substantially all of the economic benefits from the use of the asset (DAS 292.106b).

Control over the use of the identified asset
Is the customer entitled to substantially all economic benefits from the use of the identified asset throughout the period of use?
The presence of a lease requires that, throughout the period of use, the customer has the right to substantially all the economic benefits from the use of the identified asset (e.g. by having exclusive use of the asset throughout the period) (DAS 292.107). A customer can obtain economic benefits directly or indirectly from the use of the asset in many ways, such as by using, holding or sub-leasing the asset. The economic benefits from the use of the asset include both the principal and by-products produced with it (including the potential cash flows derived therefrom), as well as other economic benefits from the use of the asset that may be realised in a business transaction with a third party.

In assessing whether the customer is entitled to substantially all economic benefits from the use of the identified asset, variable lease payments that are related to economic benefits obtained from the customer's use of the asset (e.g. lease payments dependent on revenue) are not considered to be surrendering part of those economic benefits to the supplier. This is because, on the one hand, the customer receives gross incoming cash flows from the sales and, on the other hand, has an outgoing (variable) cash flow for the lease payments (DAS 292.107a).

Does the customer have the right to determine the use of the asset throughout the period of use?
The presence of a lease requires that the customer has the right to determine the use of the identified asset throughout the period of use. This is the case if the customer has the right to determine how and for what purpose the identified asset is used during the period of use, or the right to change this use. If there is an identified asset and the customer is entitled to substantially all the economic benefits from the use of the identified asset, this condition is usually met. This involves the right to make significant decisions relevant to influencing the economic benefits to be derived from the asset (DAS 292.108).

Examples of rights that indicate that a customer has the right to determine the use of the asset include, depending on the circumstances, the right to (DAS 292.108):

- decide whether the output will be realised and how much;
- change the type of output realised from the asset;
- decide at what point output will be realised; and
- decide where such output is realised.

In exceptional cases, where the asset is part of an integrated larger asset (such as network and storage facilities), and the asset cannot operate independently, the supplier has the (majority of the) right to determine the use of the asset. In these cases, the contract does not contain a lease (DAS 292.108a).

In exceptional cases, it may also be the case that the use of the asset is predetermined as a result of contractual terms (such as a take-or-pay clause, a contract where payment depends on the quantity ordered regardless of actual consumption) or by specific features in the design of the asset (such as an asset whose output is determined at the design stage). In these cases, the contract does not contain a lease unless (DAS 292.108b):

- the customer has designed the asset (or specific aspects of the asset) in such a way that its use over the entire period of use is predetermined; or
- the customer has the right to operate the asset throughout the period of use without the supplier having the right to change the operation instructions.

In assessing whether the customer has the right to determine the use of the asset, the customer only considers rights to make decisions about the use of the asset during the period of use, unless the customer has designed the asset (or specific aspects of the asset) in such a way that its use throughout the period of use is predetermined. As a result, the customer may not take into account decisions on its use predating the period of use. For example, if the customer can only determine the performance of the asset before the period of use, it does not have this right during the period of use (DAS 292.109).

Protective rights
Protective rights usually define the scope of control over the customer's use, but do not in themselves preclude the customer's right to determine the use of the asset. Examples of protective rights include terms in the contract to

protect the supplier's interest in the asset or other assets, protect its staff, or ensure the supplier's compliance with laws or regulations (DAS 292.110).

Also, the right (or obligation) of the supplier to replace the asset due to repair or maintenance, if it does not function properly or if a technical improvement becomes available, is a protective right that does not exclude the customer's right to determine the use of the asset (DAS 292.110a).

The timing of the (re)assessment of whether a contract contains a lease
The assessment of whether a contract contains a lease should be made at the time of entering into the contract based on all the facts and circumstances (DAS 292.111).

A reassessment of whether the contract contains a lease after the time of entering into the contract term should only take place if one or more of the following conditions are met (DAS 292.111):

a. there is a change in the contractual provisions, unless it is a renewal or extension of the contract;
b. there is a change in the assessment whether performance of the contract depends on a specific asset;
c. there is a significant change to the asset, e.g. a significant physical change to a tangible fixed asset; or
d. a renewal option is exercised or an extension is agreed between the parties involved, unless the option to renew or extend was already included in the original contract terms. A renewal or extension of the contract before the end of the original contract's term in which there is no adjustment to the original terms will be assessed only in relation to the renewal or extension period.

A reassessment of whether a contract contains a lease should be based on the facts and circumstances at the time of reassessment, taking into account the remaining term of the contract (DAS 292.112).

Estimation changes (e.g. the estimated amount of production that will be delivered to the customer or other potential customers) do not trigger a reassessment. If a contract is reassessed and it is determined that the contract contains a lease (or no longer contains a lease), then that lease is recognised (or its recognition is terminated) in accordance with this chapter (DAS 292.112):

- in the situations under a, b and c: from the time the change in circumstances gives rise to a reassessment;
- in the situation under d: from the time of commencement of the renewal or extension period.

Distinguishing lease payments from other payments under the contract
At the time of commencement of the contract term or at the time of reassessment, payments and other fees under the contract should be distinguished into payments relating to the lease and payments relating to the other components of the contract based on relative fair values (DAS 292.114). Minimum lease payments only include payments for the lease component (the right to use the asset) and exclude payments for the other components of the contract (e.g. for services and costs of raw materials and consumables).

In some situations, distinguishing lease payments from other payments will require a significant degree of estimation. For example, a customer may estimate the lease payments based on a lease contract for a similar asset, which does not include other components, or by estimating the payments for the other components of the contract by comparing it with contracts without a lease component and then deducting these payments from the total payments under the contract (DAS 292.115).

If a customer concludes that it is impractical to reliably split the payments, the customer should (DAS 292.116):

- in the case of a finance lease, recognise an asset and related debt at an amount equal to the fair value of the underlying asset identified as the lease object. The debt is then reduced as payments are made under the contract and a finance charge is added to the debt based on the customer's incremental borrowing rate; and
- in the case of an operating lease, recognise all payments as lease payments under the disclosure requirements of DAS 292.

22.3 Lease classification

General

The determinative factor in determining the lease classification is the beneficial ownership of the lease object. The beneficial owner bears both the advantages and disadvantages of the lease object. The advantages of the lease object may include the profitable operation over the object's economic life, the increase in the object's value or the realisation of the object's residual value. Disadvantages include the potential loss due to excess capacity, due to technical obsolescence or due to reduced revenue as a result of changed economic conditions (DAS 292.117). Depending on which party has beneficial ownership, a distinction can be made between finance leases and operating leases. If the lessee has beneficial ownership of the lease object, the lease contract is classified as a finance lease. All other leases should be classified as operating leases (DAS 292.118).

In determining the classification of a lease contract, it is the economic reality and not the legal form of the transaction that is decisive. This economic reality should be determined based on the totality of the contract terms (DAS 292.120). Lease classification should take place at the time of entering into the lease contract (DAS 292.123). The time of entering into the lease contract is when the parties have agreed on the principal provisions of the contract, no later than the date of the lease contract (DAS 292.0). If at any time the lessor and the lessee agree to amend certain terms of the contract, without entering into an entirely new contract, such that, if these amended terms had already been agreed upon the time of entering into the lease contract, this would have resulted in a different classification of the lease based on the above-mentioned classification criteria, the amended lease contract will be considered a new contract for the (remaining) lease term (DAS 292.123).

Situations involving finance leases

DAS 292 lists a number of examples of situations that, alone or combined, usually result in a lease contract being classified as a finance lease. These are the following situations (DAS 292.120):

- ownership of the lease object passes to the lessee at the end of the lease term;
- the lessee has the right to purchase the lease object at an amount well below the expected fair value of the object at the time this right can be exercised for the first time, such that upon the time of entering into the lease contract it is reasonably certain that the purchase option will be exercised (bargain purchase option);
- the lease term covers the principal part (at least 75%) of the lease object's economic life;
- the time of entering into the lease contract, the present value of the minimum lease payments is equal or nearly equal (at least 90%) to the lease object's fair value;
- the lease object is so specific that, without significant modifications, it is suitable only for use by the lessee.

Other indications or situations that, alone or combined, may also cause the lease to be classified as a finance lease (DAS 292.121) are:

- if in the event of early termination of the lease contract by the lessee, the lessee must compensate the lessor for the loss thereby incurred by the lessor;
- advantages or disadvantages due to changes in the fair value of the residual value (the residual value risk) accrue to the lessee (e.g. in the form of a discount on the lease instalments equal to the revenue from the sale of the lease objects at the end of the lease contract);
- the lessee is entitled, during or immediately after the expiry of the period for which the lessor has committed itself, to lease the lease object at a lease price significantly lower than the expected market lease price.

All these situations alone or combined are important indications that the lessee has full or almost full beneficial ownership of the leased object. The 90% criterion is one of the principal criteria for this. It is also very important to consider whether the lessee is wholly or almost wholly exposed to the risk of decrease or increase in value (also known as residual value risk). Other risks, such as maintenance risk and risk of destruction, are less relevant in the context of lease classification. For these risks, the lease instalments will generally include an adequate surcharge (depending on the specific contract terms, of course). Of particular importance for the assessment is the extent to which the lessee actually assumes the residual value risk (based on economic reality).

The examples, indications and situations mentioned above are therefore certainly not always decisive and must be treated with care. It is only on the basis of the terms of the contract as a whole that it must be concluded that the lessee does not bear all or almost all of the advantages and disadvantages associated with the ownership of the lease object and that there is therefore an operating lease (DAS 292.122).

Minimum lease payments
Minimum lease payments are the payments to which the lessee is or may be obligated during the lease term or at the end thereof (excluding contingent lease payments and excluding service charges and taxes payable by the lessor or reimbursed to the lessor), together with (DAS 292.0):

- for the lessee: any amounts guaranteed by it or a related party; and
- for the lessor: any residual value guaranteed by the lessee or a party related to the lessee, or an independent third party financially capable of fulfilling this guarantee.

If there is a bargain purchase option, the minimum lease payments include at least the lease instalments due during the lease term and the amount due upon exercise of the right of purchase.

Lease term
The lease term is the non-cancellable period during which the lessee has committed to lease the asset, together with any further periods for which the lessee has the right to extend the lease with or without further payment, to the extent that it is reasonably certain at the time of entering into the lease contract that the lessee will exercise this right (DAS 292.0).

Land and buildings
Lease contracts relating to land and buildings should be classified according to the same criteria as other lease contracts. If a lease contract contains both land and buildings, then these components should be classified separately based on those criteria. The economic life of land is mostly indefinite. If the economic life of land is indefinite, this component is usually classified as an operating lease (DAS 292.124). For the lease term will then usually be shorter than the economic life.

Bargain purchase option
In assessing whether a bargain purchase option exists under a lease contract, there is generally an interest on the part of both the lessor and the lessee not to classify a purchase option as a bargain. This is based on the often present preference of lessees to be able to classify the lease as an operating lease and the interest that lessors have to be able to offer an 'operating lease product'. Under DAS 292.120, a bargain purchase option exists if the lessee has the right to purchase the lease object at an amount well below the expected fair value of the object at the time this right can be exercised for the first time, such that at the time of entering into the lease contract it is reasonably certain that the option will be exercised. Factors influencing whether a bargain purchase option exists are, in our view:

- the ratio between exercise price and expected fair value at the time the option can be exercised. Essential is to determine how to apply the following provision: 'exercise price far below expected fair value'. It seems that DAS 292, with the wording 'far below', has given a heavier interpretation to the relevant provision under IFRS ('sufficiently lower'). Our view is that this difference was not deliberately created. In our opinion, it can be assumed that the provision of DAS 292 is not intended to deviate from the relevant provision in IFRS;
- the number of years after which the option can be exercised;
- the extent to which the expected fair value of the asset could fluctuate; and
- the extent to which the asset in question is specifically tailored to the activities of the lessee and cannot simply be used by third parties.

We believe that each purchase option should be assessed separately using the four factors mentioned above to determine whether a bargain purchase option exists. Here, the starting point should be the assumption that any purchase option with a fixed exercise price leads to a rebuttable presumption of a bargain purchase option. This presumption is certainly present if the fixed exercise price is determined on the basis of a fixed depreciation percentage, where the expected market development for the asset in question is likely to be an entirely different one.

22.4 Recognition, measurement and determination of profit or loss

The method of recognition, measurement and determination of profit or loss depends on the classification of the lease contract. In addition, a distinction should be made between recognition of the contract in the financial statements of the lessor and the lessee.

22.4.1 Recognition of finance leases in the lessee's financial statements

22.4.1.1 Initial recognition

In the case of finance leases, both the lease object and the related debt must be recognised at fair value in the lessee's balance sheet upon commencement of the lease term. Both are determined at the time of entering into the lease contract (DAS 292.201). If the present value of the minimum lease payments is less than the fair value mentioned above, the lease object and the related debt should be recognised at the present value of the minimum lease payments.

Discount rate to be used
When discounting minimum lease payments, the interest rate implicit in the lease should be used unless it is impracticable to determine (DAS 292.201). The interest rate implicit in the lease is the interest rate that follows, from the lessor's perspective, from the equation of, on the one hand, the present value of the minimum lease payments as defined for the classification by the lessor and, on the other hand, the unguaranteed residual value and the fair value of the lease object and the capitalised initial direct costs of the lessor, all determined at the time of entering into the lease contract (DAS 292.0). If the interest rate implicit in the lease is not practical to determine, the incremental borrowing rate should be used (DAS 292.201). The lessee's incremental borrowing rate is the interest rate at which the lessee would have been able to enter into a similar lease or, if it cannot be determined, the interest rate at which the lessee would have been able to borrow, at the time of entering into the lease contract, the amount necessary to purchase the asset for a corresponding period of time and with corresponding security (DAS 292.0).

The example below shows how the interest rate implicit in the lease is determined.

Example: Calculation of interest rate implicit in the lease and minimum lease payments

A lease contract is entered into on 1 January of year 1 for a period of three years; the lease object that can be used from 1 January of year 1, has an expected economic life of five years. Under the lease contract, the lessee is obliged to make the following payments:

31 December of year 1	50,000
31 December of year 2	50,000
31 December of year 3	50,000

The lessee depreciates equivalent assets on a straight-line basis. The fair value of the lease object at the time of entering into the lease contract is 131,856. The unguaranteed residual value is 10,000. Initial costs are negligible. The interest rate implicit in the lease is determined based on these data. The interest rate implicit in the lease follows from equating the present value of the minimum lease payments and the unguaranteed residual value, on the one hand, and the fair value of the lease object, on the other. At a discount rate of 10%, the respective amounts are equal. This sets the interest rate implicit in the lease at 10%. See the equation below used to determine the interest rate implicit in the lease.

PV of the unguaranteed residual value:	$10,000 / (1 + 0.10)^3$	7,513
PV of the annual lease payments:	$50,000 / (1 + 0.10)^1$	45,455
	$50,000 / (1 + 0.10)^2$	41,322
	$50,000 / (1 + 0.10)^3$	37,566
Total PV of minimum lease payments and unguaranteed residual value:		131,856

Initial direct costs
The lessee's initial direct costs of the lessee should also be included in the initial recognition of the asset (DAS 292.201). Initial direct costs are the incremental costs (the additional costs) directly attributable to the negotiation and conclusion of the lease contract (DAS 292.0). For example, commission costs to be borne by the lessee that have to be paid to an intermediary or legal costs that have to be incurred in order to be able to settle the lease transaction.

22.4.1.2 Subsequent measurement

Minimum lease payments should be split between interest expense and reduction of the outstanding liability. During the lease term, interest expense should be allocated to each period such that it results in a constant periodic interest rate on the remaining net liability (average in each period) relating to the finance lease. A calculation method that approximates this allocation method can be used for practical reasons. Contingent lease payments should be recognised as an expense in the period in which the conditions for payment are met (DAS 292.206).

The recognition of a finance lease should result in the recognition of both depreciation expense on the lease object, and interest expense on the lease liability (DAS 292.207).

If there is no reasonable certainty that the lessee will become the owner at the end of the lease term, the lease object should be depreciated over the shorter of the lease term or the economic useful life of the object (DAS 292.207).

Example: Recognition of finance lease in lessee's financial statements (extracted from DAS 292)

A lessee enters into a lease contract for certain equipment at the beginning of year 1. The fixed term of the lease contract is eight years. The expected economic life is 10 years. The lessee has to make a lease payment of 29,382.40 at the end of each year. The lease object returns to the lessor at the end of the lease contract. The fair value of the equipment at the start of the lease contract is 150,000. The equipment has an expected residual value of 10,000 at the end of the lease contract. The lease contract is classified as a finance lease.

The interest rate implicit in the lease is determined by equating the present value of the minimum lease payments and the unguaranteed residual value, on the one hand, to the fair value of the lease object, on the other. Based on this equation, the interest rate implicit in this lease contract is set at 12% (present value of lease payments in years 1 through 8 in the amount of 29,382.40 + present value of unguaranteed residual value at the end of year 8 in the amount of 10,000 = fair value of lease object of 150,000).

Upon commencement of the lease term, the lessee recognises the leased equipment and the related lease liability on the balance sheet. This is done at the present value of the minimum lease payments of 145,961.20, as this amount is lower than the fair value of the leased equipment. On initial recognition of this finance lease, the lessee enters the following:

Leased equipment	145,961.20	
Lease liability		145,961.20

The leased equipment is depreciated over eight years, being the shorter of the lease term and the economic life of the equipment. This leads to an annual depreciation in the amount of 18,245.15.

The annual lease payments are split into interest expense and repayment of the outstanding lease liability. During the lease term, interest expense is allocated to each period such that it results in a constant periodic interest rate on the remaining net lease liability (average in each period). Under this lease, the annual interest expense is 12% (interest rate implicit in the lease). The lessee enters the following in year 1:

Depreciation charges (= 145,961.20 / 8)	18,245.15	
Leased equipment		18,245.15
Lease liability (= 29,382.40 - 12% of 145,961.20)	11,867.06	
Interest expense (= 12% of 145,961.20)	17,515.34	
Bank		29,382.40

The lessee then enters the following in year 2:

Depreciation charges	18,245.15	
Leased equipment		18,245.15
Lease liability (= 29,382.40 - 12% of (145,961.20 - 11,867.06))	13,291.10	
Interest expense (= 12% of (145,961.20 - 11,867.06))	16,091.30	
Bank		29,382.40

Impact of purchase options on depreciation period

Paragraph 22.3 indicated that a lessee may have the right to purchase the lease object at an amount far below the expected fair value of the object at the time this right can be exercised for the first time (bargain purchase option). As a result, at the time of entering into the lease contract, it will be reasonably certain that the purchase option will be exercised. As a result, the lease contract will be classified as a finance lease. Subsequently, the depreciation period will have to be based on the expected useful life of the asset, even if the lease term is shorter. For it is expected that at the end of the lease contract, the lessee will also acquire legal ownership of the asset and continue to use it for its operations during its remaining useful life. This situation is not substantially different from a company buying an asset where the required purchase price is fully funded and the asset is given as security. In other words, only if there is no reasonable certainty that the lessee will become the owner at the end of the lease term, should the lease object be depreciated over the shorter of the lease term or the useful life of the object (DAS 292.207).

22.4.2 Recognition of operating leases in the lessee's financial statements

If a lease contract is classified as an operating lease, the lessee may not capitalise the lease object. However, should the lessee have incurred significant obligations over longer periods, it should disclose this in the notes (DAS 292.210). A further explanation of this issue is given in DAS 252 ‘Provisions, off-balance sheet liabilities and off-balance sheet assets’ (see Chapter 20). Under this form of lease, the lessee should recognise the lease payments (excluding service fees such as insurance and maintenance costs) as an expense in the profit and loss account on a straight-line basis over the lease term, unless another allocation system is more representative of the pattern of benefits to be obtained from the lease object (DAS 292.211).

In practice, it does happen that the lessor pays fees as an incentive for the lessee to enter into a lease contract (lease incentives). Lease incentives can be provided in the form of a rent-free period. Lease incentives can also take a different form. Examples include reimbursements for moving expenses or reimbursements for renovations performed by the lessee. Whether a renovation carried out by the lessor constitutes a lease incentive must be assessed based on the specific facts and circumstances. Lease incentives are recognised by the lessee as a reduction of the lease costs. That reduction should be allocated on a straight-line basis over the lease term, unless another allocation system is more representative of the pattern of benefits to be derived from the lease object (DAS 292.211).

Example: Recognition of lease incentives

A lessee enters into a contract to lease a building for a period of 15 years. The lessee has agreed with the lessor that no rent is payable for the first 36 months of the lease term. After the 36-month rent-free period, the rent will be 10,000 per month.

The lessee has to pay a total of 12 x 12 x 10,000 = 1,440,000 in rent during the lease term. Per month, the rent cost is then 1,440,000 / (15 x 12) = 8,000. During the first 36 months of the lease term, the lessee records the following monthly journal entry:

Lease costs	8,000	
Lease incentives received in advance		8,000

After the end of the rent-free period, the lessee records the following monthly journal entry:

Lease costs	8,000	
Lease incentives received in advance	2,000	
Bank		10,000

The 'lease incentives received in advance' entry amounts to 288,000 after 36 months. This entry is released to nil for 144 (12 x 12) months. As this example shows, the lease costs are the same throughout the lease term (i.e. even during the rent-free period) in accordance with the even pattern of benefits obtained during this term.

22.4.3 Recognition of finance leases in the lessor's financial statements

22.4.3.1 Initial recognition

General recognition method
Under a finance lease, the lease object must be recognised by the lessor as a receivable. The receivable should be recognised at the amount of the net investment in the lease (DAS 292.301). Net investment in the lease is the present value of the gross investment in the lease calculated at the interest rate implicit in the lease contract (DAS 292.0). The gross investment in the lease is the sum of the minimum lease payments under the finance lease considered from the lessor and any unguaranteed residual value accruing to the lessor (DAS 292.0). The unearned finance charge is the difference between the gross investment in the lease and the net investment in the lease (DAS 292.0).

Initial direct costs
If the lessor incurs initial direct costs, such as commissions and legal fees, in respect of a finance lease, these are incurred to earn interest income. For finance leases where the lessor is not a manufacturer or dealer, these initial direct costs may be included in the initial recognition of the lease receivable, reducing income over the lease term. These initial direct costs are therefore taken into account when determining the interest rate implicit in the lease. These costs can also be recognised directly as an expense (DAS 292.303).

Manufacturer or dealer acts as lessor
In the event that the manufacturer or dealer itself acts as lessor, it should recognise a transaction profit or loss on the sale in accordance with the accounting principles it normally applies to ordinary sales transactions. If the lessee is charged a significantly lower interest rate than the market interest rate, the transaction profit or loss should be reduced by the difference between the present value of future lease payments calculated with the (lower) interest rate charged and that with the market interest rate. If the manufacturer or dealer incurs initial direct costs, these should be charged to the profit and loss account at the time of entering into the lease contract (DAS 292.304).

22.4.3.2 Subsequent measurement

The lease payments received should be split into a repayment portion and interest income. This interest income should be recognised so that a constant periodic yield is achieved in each year of the lease term, calculated over the remaining net investment (average in each period) related to the finance lease (DAS 292.309).

Example: Recognition of finance lease in lessor's financial statements (extracted from DAS 292)

A lessor and a lessee enter into a lease contract for certain equipment. The lessor is also the manufacturer of this equipment. The fixed term of the lease contract is eight years. The expected economic life is 10 years. The lessee has to make a lease payment of 29,382.40 at the end of each year. The lease object returns to the lessor at the end of the lease contract. The selling price (fair value) of the equipment at the start of the lease contract is 150,000. The cost of the equipment is 100,000. The equipment has an expected residual value of 10,000 at the end of the lease contract. Upon entering into the lease contract, the lessor incurred initial direct costs of 2,500. The lease contract is classified as a finance lease.

The interest rate implicit in the lease is determined by equating the present value of the minimum lease payments and the unguaranteed residual value, on the one hand, to the fair value of the lease object, on the other. As the lessor is a manufacturer here, the initial costs of the lessor are not included in the calculation of the interest rate implicit in the lease. Based on this equation, the interest rate implicit in this lease contract is set at 12% (present value of lease payments in years 1 through 8 in the amount of 29,382.40 + present value of unguaranteed residual value at the end of year 8 in the amount of 10,000 = fair value of lease object of 150,000).

The gross investment in the lease is the total of the minimum lease payments plus the unguaranteed residual value and amounts to 245,059.20 (= (29,382.40 x 8) + 10,000). The net investment in the lease represents the present value of the gross investment and amounts to 150,000 at an interest rate implicit in the lease of 12%. This amount is equal to the fair value of the equipment. The cost of the equipment sold is 98,461.20 (= the historical cost of the equipment (100,000) + the initial direct costs (2,500) - the present value of the residual value (4,038.80)).

On initial recognition of this finance lease, the lessor enters the follow:

Lease receivable	150,000.00	
Cost of the equipment sold	98,461.20	
Inventory		100,000.00
Net revenue		145,961.20
Bank / Accounts payable (in respect of initial direct costs)		2,500.00

The transaction profit of the lessor is therefore 47,500 (= 145,961.20 - 98,461.20). This transaction profit is equal to the fair value of 150,000 minus the carrying amount of the inventory of 100,000 and the initial direct costs of 2,500. The present value of the residual value (4,038.80) is not recognised as either net revenue or cost upon commencement of the lease term.

The annual lease payments are split between interest income and repayment of the outstanding lease receivable. During the lease term, interest income is allocated to each period such that it results in a constant periodic interest rate on the remaining net lease receivable (average in each period). The annual interest income is 12% under this lease. The lessor enters the following in year 1:

Bank	29,382.40	
Lease receivable (= 29,382.40 - 12% of 150,000)		11,382.40
Interest income (= 12% of 150,000)		18,000.00

The lessor then enters the following in year 2:

Bank	29,382.40	
Lease receivable (= 29,382.40 - 12% of (150,000 - 11,382.40))		12,748.29
Interest income (= 12% of (150,000 - 11,382.40))		16,634.11

At the end of year 8, the equipment returns to the lessor and the lessor will make the following entry (based on the expected residual value and repayments of the outstanding lease receivable):

Equipment	10,000.00	
Lease receivable		10,000.00

If at the end of year 8 the fair value of the equipment is less than 10,000 a write-down will have to be made.

In the example, the initial costs are charged directly to profit or loss. A manufacturer or dealer should also recognise this in a normal sales transaction. It should be borne in mind that manufacturers and dealers often offer their customers the choice between buying or leasing. A finance lease of a property leads to two types of income for the manufacturer or dealer lessor, namely, on the one hand, the normal transaction profit or loss (based on normal prices and discounts, which also apply to transactions that do not involve a lease) and, on the other hand, a normal financing fee over the lease term (DAS 292.305).

If the lessor in the example were not a manufacturer or dealer, the present value would have to be equated 152,500 (instead of 150,000). The interest rate implicit in the lease (required to discount to this amount) would then be lower and with it the interest income that would be recognised over the lease term. That way the initial costs are spread over the lease term by means of a lower interest compared to the example.

22.4.4 Recognition of operating leases in the lessor's financial statements

General recognition method
If there is an operating lease, the lessor should recognise the lease object on the balance sheet according to the nature of the object (DAS 292.312).

Lease income (excluding service fees such as insurance and maintenance) as a component of the lease payments should be recognised by the lessor on a time-proportionate basis over the lease term, unless another method of allocation is more representative under the specific circumstances of how the economic benefits of the lease object diminish in value (DAS 292.313).

The lease object is depreciated in a similar manner to the accounting principles applied by the lessor for the same category of assets (DAS 292.316).

Initial direct costs
Initial direct costs incurred to generate income from operating leases are either allocated over the lease term against lease income or charged directly to the profit and loss account (DAS 292.315). Initial costs do not include reimbursements paid by the lessor to the lessee or third parties as incentives for the lessee to enter into a contract (lease incentives).

Lease incentives
Lease incentives are reimbursements paid by the lessor to the lessee or third parties as an incentive for the lessee to enter into a contract. Lease incentives should be allocated on a time-proportionate basis over the lease term, unless another method of allocating the income generated from the lease object is more representative (DAS 292.315).

22.5 Sale-and-leaseback transactions

A 'sale-and-leaseback transaction' is a transaction in which an asset is sold and the same asset is leased back. The method of recognition of sale-and-leaseback transactions depends on the classification of the lease contract (DAS 292.401).

If a sale-and-leaseback transaction results in a finance lease, the lessee must spread any positive difference between the sale proceeds and the carrying amount over the lease term in its financial statements (DAS 292.402).

If a sale-and-leaseback transaction results in an operating lease, recognition depends on the carrying amount, fair value and sale price of the lease object (DAS 292.404). If the sale price equals the fair value, any gain or loss on disposal is recognised immediately in the seller's/lessee's profit and loss account. However, the sale price may not equal the fair value of the lease object:

- if the sale price is higher than the fair value, this difference will be repaid through future higher lease payments. Therefore, only the difference between the fair value and the carrying amount is recognised immediately as gain or loss on disposal in the profit and loss account. The difference between the sale price and the fair value is recognised as an accruals and deferred income item. Such accruals and deferred income item is released to profit or loss over the period during which the asset is expected to be used;
- if the sale price is lower than the fair value, the difference between them is recognised as a prepayments and accrued income item to the extent that it is offset by future lower lease payments. Such prepayments and accrued income item is depreciated to profit or loss in proportion to the lease payments during the period the asset is expected to be used.

Appendix 3 of DAS 292 provides a diagram of sale-and-leaseback transactions leading to an operating lease.

Example: Sale-and-leaseback transaction

Company A enters into a sale-and-leaseback transaction with a leasing company in respect of all its real estate. At the time of the transaction, the carrying amount of the real estate is 100 and the fair value is 200. The remaining economic life and useful life of the real estate is estimated at 25 years. In the sale-and-leaseback transaction, a sale price of the real estate of 400 is agreed. The real estate is leased back for a period of 20 years. A does not have a purchase option at the end of this contract. The present value of the minimum lease payments is 350. The method used to recognise this transaction depends on the classification of the lease contract.

If the lease contract classifies as an operating lease, it constitutes a real sale, which must be recognised as such. The difference between the fair value and the carrying amount of 100 (= 200 - 100) must be taken by A directly as profit. An amount of 200 (= 400 - 200) is not a real profit, since it sells for a higher price than the fair value of the object. This 200 should be recognised as an accruals and deferred income item and released to profit or loss over the period during which the asset is expected to be used. This release effectively compensates for the excessive operational lease instalments that will have to be charged to profit or loss over the next 20 years. The balance of operating lease costs (lease instalment minus the periodic release of the accruals and deferred income item) now reflects the lease costs that would have been charged under a normal selling price.

In case the lease contract classifies as a finance lease, there is no sale. The relevant asset therefore remains at 100 in A's balance sheet. A continues to amortise the asset. In substance, it constitutes funding. This means that A recognises a lease liability equal to the present value of the minimum lease payments (350). A recognises the difference between the sale price and the present value of the lease liability as an 'accruals and deferred income' item (50). This item actually constitutes the sold residual value of the asset after 20 years. The entry on initial recognition is as follows:

Bank	400	
Lease liability		350
Accruals and deferred income		50

After initial recognition, the real estate is amortised over the shorter of the lease term or the useful life of the property. In this example, due to the lack of a (bargain) purchase option, this is the 20-year lease term. The lease payments are split into interest expense and repayment of the outstanding lease liability. During the lease term, interest expense is allocated to each period such that it results in a constant periodic interest rate on the remaining net liability (average in each period) relating to the finance lease. The accruals and deferred income item is released to the profit and loss account on a straight-line basis over the lease term. As a result of the sale-and-leaseback transaction, the amortisation per year increases, as the real estate is now amortised over the lease term (20 years), which is shorter than the original remaining amortisation period. This higher amortisation is offset by the release of the accruals and deferred income item.

The above assumes that A does not have the right to purchase the asset at the end of the lease term. If that right does exist and the purchase option is considered a bargain purchase option, the contract will be classified as a finance lease and amortisation will continue to take place over the remaining useful life of the asset of 25 years (DAS 292.207/ paragraph 22.4.1.2). Compared to the example above, the purchase price will then be lower and/or the present value of the lease liability will be higher. After all, the leasing company will want to earn a real return on the amount lent.

22.6 Composite transactions

A series of contracts, including a lease contract, is interrelated and should be recognised as a single transaction when the overall economic effect cannot be assessed without considering the series of contracts as a whole (DAS 292.502). The recognition of such a set of agreements should reflect their economic reality (DAS 292.503). All aspects and consequences of such a transaction that have an economic impact should be considered. Indications that a transaction is not a lease contract in terms of economic reality are (DAS 292.504):

- the legal entity retains the advantages and disadvantages associated with ownership of the asset and effectively has the same user rights as before the transaction;
- the principal objective of the transaction is to achieve a particular tax benefit, and not to transfer the right to use an asset; or
- one of the conditions is an option that will almost certainly be exercised. For example, a put option that can be exercised at a price significantly higher than the expected fair value at the time of exercise.

Appendix 4 of DAS 292 provides some examples of compound transactions with the legal form of a lease contract. DAS 292.5 applies amongst others to so-called 'cross-border leases'.

Liabilities arising from compound transactions with the legal form of a lease contract, such as guarantees issued and obligations in the event of early termination, should be recognised on the basis of DAS 252 ‘Provisions, off-balance sheet liabilities and off-balance sheet assets’ and DAS 290 ‘Financial instruments’ (DAS 292.506), depending on the conditions.

22.7 Special purpose entity

In some cases, lease contracts are concluded with special purpose entities (hereinafter: SPEs) as lessors. In these cases, the lessee, or an entity belonging to the lessee's group, acts vis-à-vis the SPE in a capacity (e.g. shareholder, financier or guarantor) other than that of lessee. The terms of the lease contract between the two parties are sometimes determined in such a way that, if only the lease is considered, it is an operating lease. The lessee, or another entity belonging to the group, may bear part of the economic risk in respect of the lease object in the capacity other than that of lessee. The economic risk borne by the lessee or an entity related to the lessee in the capacity other than that of lessee must also be taken into account in assessing whether the contract terms as a whole indicate that a finance lease exists (DAS 292.130). Obviously, if SPEs are used, their inclusion in the consolidation scope must also be assessed. See Chapter 33.

22.8 Presentation and disclosure

The Dutch Accounting Standards Board has formulated an explicit objective of providing information on lease contracts entered into. Above all, that objective must be achieved in applying the disclosure requirements set out below. That objective, together with the information included on the balance sheet, profit and loss account and cash flow statement, is to provide insight into the impact that leases have on equity, profit or loss and cash flows. Both lessees and lessors must, for both finance and operating leases, provide a general description of the principal provisions included in the lease contracts. In addition, an important part of disclosure is that lessees, for both finance and operating leases, provide a maturity analysis of future minimum lease payments.

For all disclosures, information relating to the comparative reporting period must also be provided.

22.8.1 Disclosure of finance leases in the lessee's financial statements

To fulfil the disclosure objective stated above, a lessee includes the following information in the notes on finance leases (DAS 292.208):

- for each asset category, the carrying amount on the reporting date and a statement that the entity is not the legal owner to the extent not already reflected on the balance sheet;
- a maturity analysis based on the most relevant reporting periods of the future minimum lease payments;
- a general description of the principal provisions included in the lease contracts;
- the amount of contingent lease payments recognised as an expense in the period; and
- the total of future minimum sublease payments expected to be received in respect of subleases not subject to early termination on the reporting date.

Based on Article 2:375(2) NCC, the maturity analysis covers the following reporting periods:

- no more than one year after the reporting date;
- more than one year and not more than five years after the reporting date; and
- more than five years after the reporting date.

The maturity analysis depends on the amounts of the lease payments in the different reporting periods and the nature of the lessee's business activities and has an appropriate presentation, for example also by asset category. In order to meet the above-mentioned disclosure objective, depending also on the differences in the annual lease payments, there may be reason to provide a maturity analysis that is more detailed than that prescribed by law.

The general description of the principal provisions included in the lease contracts may include:

- further presentation by asset category as recognised in the financial statements;
- the terms of contingent lease payments;
- the existence and content of renewal options, purchase options or pass-through clauses; and
- restrictions arising from the lease contracts, such as with regard to dividend payments, additional financing and entering into other lease contracts.

Furthermore, if applicable, the disclosure requirements of DAS 210 'Intangible fixed assets' (see Chapter 5), DAS 212 'Tangible fixed assets' (see Chapter 7), DAS 213 'Investment property' (see Chapter 8), DAS 121 'Impairment of fixed assets' (see Chapter 10) and DAS 254 'Liabilities' (see Chapter 19) apply.

22.8.2 Disclosure of operating leases in the lessee's financial statements

To fulfil the disclosure objective stated above, a lessee includes the following information in the notes on operating leases (DAS 292.212):

- a maturity analysis based on the most relevant reporting periods of the future minimum lease payments. The maturity analysis should cover at least the following periods:
    - the period not exceeding one year from the reporting date;
    - the period longer than one year and no longer than five years after the reporting date; and
    - the period longer than five years from the reporting date;

- a description of the principal lease objects recognised as operating leases;
- a general description of the principal provisions included in the lease contracts;
- the total of future minimum sublease payments expected to be received in respect of subleases not subject to (early) termination on the reporting date;
- lease payments and sublease payments recognised as revenue in the profit and loss account during the reporting period; and
- if DAS 292.116(b) applies (impractical to split payments reliably), the statement that the amounts disclosed include payments for non-lease components under the contract.

The maturity analysis depends on the amounts of the lease payments in the different reporting periods and the nature of the lessee's business activities and has an appropriate presentation, for example also by principal lease object. In order to meet the above-mentioned disclosure objective, depending also on the differences in the annual lease payments, there may be reason to provide a more detailed maturity analysis.

The general description of the principal provisions included in the lease contracts may include:

- further presentation by principal lease object;
- the terms of contingent lease payments;
- the existence and content of renewal options, purchase options or pass-through clauses; and
- the restrictions arising from the lease contracts, such as with regard to dividend payments, additional financing and entering into other lease contracts.

22.8.3 Disclosure of finance leases in the lessor's financial statements

To fulfil the disclosure objective stated above, a lessor includes the following information in the notes on finance leases (DAS 292.311):

- a reconciliation between the gross investment in the lease and the present value of future minimum lease payments on the reporting date;
- the gross investment in the lease and the present value of the minimum lease payments on the reporting date for each of the following periods:
    - the period not exceeding one year from the reporting date;
    - the period longer than one year and no longer than five years after the reporting date; and
    - the period longer than five years from the reporting date;
- the unearned interest income;
- the unguaranteed residual value of the lease objects of which the lessor has beneficial ownership;
- the cumulative provision for uncollectibility deducted from the present value of the minimum lease payments;
- the amount of contingent lease payments recognised as revenue in the period; and
- a general description of the principal provisions included in the lease contracts.

In order to meet the above-mentioned disclosure objective, depending also on the differences in the annual lease payments, there may be reason to provide a more detailed maturity analysis.

The general description of the principal provisions included in the lease contracts may include the existence and content of renewal options, purchase options or pass-through clauses and any residual value guarantees present.

22.8.4 Disclosure of operating leases in the lessor's financial statements

To fulfil the disclosure objective stated above, a lessor includes the following information in the notes on operating leases (DAS 292.319):

- the future minimum lease payments for lease contracts that cannot be terminated (early) for each of the following periods:
    - the period not exceeding one year from the reporting date;
    - period longer than one year and not more than five years after the reporting date; and
    - the period longer than five years from the reporting date;
- the amount of contingent lease payments recognised as revenue in the period; and

- a general description of the principal provisions included in the lease contracts.

In order to meet the above-mentioned disclosure objective, depending also on the differences in the annual lease payments, there may be reason to provide a more detailed maturity analysis.

The general description of the principal provisions included in the lease contracts may include the existence and content of renewal options, purchase options or pass-through clauses and any residual value guarantees present.

Furthermore, if applicable, the disclosure requirements of DAS 210 'Intangible fixed assets' (see Chapter 5), DAS 212 'Tangible fixed assets' (see Chapter 7), DAS 213 'Investment property' (see Chapter 8) and DAS 121 'Impairment of fixed assets' (see Chapter 10) apply.

22.9 Exemptions for medium-sized and small entities

Medium-sized entities as lessees for the disclosure of operating leases are exempt from including the statement that the amounts disclosed also include payments for non-lease components under the contract, if DAS 292.116(b) applies (impracticable to reliably split payments between the lease components and the other components of a contract).

Medium-sized entities as lessors for the disclosure of finance leases are exempt from disclosing:

- the reconciliation between the gross investment and the present value of the minimum lease payments (DAS 292.311(a)); and
- the cumulative provision for uncollectibility deducted from minimum lease payments (DAS 292.311(d)); and
- the amount of contingent lease payments recognised as revenue in the period (DAS 292.311(e)).

Medium-sized entities as lessors for the disclosure of operating leases are exempt from disclosing the amount of contingent lease payments recognised as revenue in the period (DAS 292.319(b)).

Small entities are exempt from the obligation to assess whether a contract contains a lease for those contracts that do not primarily qualify as lease contracts.

Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the statutory minimum') in the notes.

22.10 Significant differences from IFRS

Recognition of operating leases by lessees
Under IFRS 16, lessees must recognise all leases on the balance sheet by recognising a lease asset and a lease liability (with the exception of short-term leases and low-value leases). Short-term leases are leases with a lease term of up to 12 months. Low-value leases are leases of lease objects with low new value (e.g. leases of laptops and smartphones). The lease asset concerns the right to use the lease object. So not the lease object itself. The lease liability represents the present value of the lease payments over the lease term. DAS 292 states that a lease contract should be classified as either an operating lease or a finance lease based on the economic reality of the contract terms as a whole. Operating leases are not recognised on the balance sheet by lessees, but are disclosed.

Initial direct costs incurred by lessors of finance leases (excluding manufacturers/dealer lessors)
According to IFRS 16 'Leases', initial direct costs incurred by lessors of finance leases should be included in the initial measurement of the lease receivable. DAS 292 leaves a choice between this recognition method and charging it directly to profit or loss.

Initial direct costs incurred by lessors of operating leases
Under IFRS 16 'Leases', initial direct costs incurred by lessors of operating leases should be included in the initial measurement of the underlying asset and amortised over the term of the lease contract.
DAS 292 leaves a choice between this recognition method and charging it directly to the profit and loss account.

23 Profit and loss account

23.1 Introduction

Income and expenses
The profit and loss account relates to income and expenses. Income refers to growth in economic potential during the reporting period in the form of inflows of new assets or increases in existing assets, or reductions in liabilities, all resulting in increases in equity, other than through contributions from participants therein. Expenses are reductions in economic potential during the reporting period in the form of outflows or depletion of assets, or the origination of liabilities, all resulting in a decrease in equity other than through distribution to participants therein. This shows the close relationship that exists between the recognition of income and expenses and the recognition of assets and liabilities. If the criteria for recognising (or derecognising) an asset or liability are met, then the criteria for simultaneously recognising the associated income or expense are also met (see also Chapter 2). Income and expenses may also include income and expenses that are not recognised in the profit and loss account, but which do lead to a change in equity (see also Chapter 24).

Further delineation of this chapter
This chapter focuses on the general principles concerning the profit and loss account. Some specific topics are covered in more detail in:

- Chapter 24 on the statement of comprehensive income;
- Chapter 26 on revenue recognition;
- Chapter 27 on the recognition of borrowing costs.

For the following specific topics, please refer to the relevant chapters, namely:

- income and expenses due to corrections to previous years (Chapter 3);
- depreciation and amortisation on tangible and intangible fixed assets (Chapters 5, 6 and 7);
- impairment of fixed assets (Chapter 10);
- cost of goods consumed and allocation of expenses to work in progress (Chapter 11);
- cost of construction contracts and project development (Chapter 12);
- expenses under other provisions (Chapter 16); and
- income taxes (Chapter 17).

23.2 Legal principles

Article 2:362(3) NCC states that the profit and loss account and notes must give a fair, clear and consistent view of the size of profit or loss for the financial year and of the composition of the income and expenses. Furthermore, Article 2:362(5) NCC stipulates that income and expenses for the financial year are included in the financial statements, regardless of whether they resulted in receipts or payments during the financial year (accrual principle). Therefore, in the majority of cases, a transaction or event is recognised before its financial settlement. Accordingly, under Article 2:362(5) NCC, application of the cash accounting system is almost never acceptable.

23.3 Timing of recognition

Chapter 26 'Revenue recognition' explains in more detail the assumptions for the 'occurrence' of sales transactions (and hence revenue). This paragraph briefly discusses the recognition of expenses. Indeed, the relevant regulations, which are contained in the *Stramien* and the Dutch Accounting Standards, have already been explained in detail in Chapter 2, among others.

In the recognition of expenses, the accrual principle, the prudence principle and, to a lesser extent, the matching principle apply. These principles mean that expenses associated with a company's performance should be allocated to the period in which the income associated with that performance is recognised. Here, economic reality should always be kept in mind. However, this allocation of expenses to income should not result in assets being recognised in violation of the criteria for asset recognition (DAS 135.205). Because the so-called balance sheet approach is the primary principle in financial reporting in the *Stramien* and the Dutch Accounting Standards, the significance of the matching principle is less than if the profit or loss approach were the primary principle. The balance sheet approach involves primarily determining whether there is an asset or a liability. It must then be assessed whether the criteria for recognition on the balance sheet are met. Examples of costs that are not capitalised as a result of this approach are start-up costs and expenditures on training and advertising (DAS 210.235).

Example: Timing of recognition (1)

If profit sharing is paid after the end of the financial year as compensation for performances delivered during the financial year (e.g. by the employees of a company), the profit sharing payable should be recognised as an expense in the profit and loss account for the year in which the performances were delivered and thus to which the profit sharing relates.

If profit sharing is paid as compensation for the provision of equity, recognition is done as part of profit appropriation. In that case, therefore, no expense is recognised.

Example: Timing of recognition (2)

Warranty costs are attributable to the event that incurs them. That is not the moment when defects become apparent, but the moment when the product or service sold under warranty is delivered. This warranty commitment can take place either in legal form (legal obligation) or by way of service (constructive obligation). Therefore, the expenses (the best estimate of costs to be reimbursed in the future) should be recognised in the profit and loss account for the year in which the products or services were sold and delivered.

23.4 Classification

23.4.1 General

The general principles regarding the presentation of the profit and loss account are laid down in Article 2:377 NCC. The first paragraph of this article prescribes the main classification, being the separate disclosure of:

- income and expenses from ordinary operations, taxes thereon and profit or loss on ordinary operations after tax;
- other taxes;
- profit or loss after tax.

No distinction is made between ordinary and extraordinary income and expenses. It is therefore notable that Article 2:377(1) NCC still requires income and expenses, taxes and profit or loss 'on ordinary operations' to be disclosed separately in the profit and loss account. This is an omission. The models from the Decree on annual accounts format (BMJ) overcome this. In it, the term 'ordinary operations' no longer appears. In the Decree on annual accounts format, the item 'profit or loss on ordinary operations before tax' has been replaced by 'profit or loss before tax'. The item 'taxes on profit or loss on ordinary operations' has been replaced by 'taxes'.

23.4.2 Presentation by nature of expense versus by function

Income and expenses from ordinary operations must be broken down according to presentation by nature of expense (Article 2:377(3) NCC) or by function (Article 2:377(4) NCC). A mixture of the two presentations is not allowed.

Presentation by nature of expense
The presentation by nature of expense is detailed in models E and I of the Decree on annual accounts format (BMJ). These models are based on the so-called production/revenue method. This means that after net revenue, changes in inventory of finished product and inventory of work in progress, capitalised production on behalf of own business and other revenue are included. Through these inventory and/or production items, incorrect matching of production costs and sales revenue is prevented. This is because, on balance, this leaves the income and expenses attributable to sales performance for the year in question.

Model I is less comprehensive in scope and therefore only allowed for small and medium-sized enterprises.

Example: Presentation by nature of expense

In a year, a manufacturing company produces items with a sales value of 2,000. Due to the very poor sales market, the company only manages to sell these items the following year. Then, the entire production of that year will also be sold (again with a value of 2,000). The annual costs are: raw materials and consumables 800, wages and salaries 600, and depreciation 400. Of these costs, 1,600 is attributable to production. The other costs consist of selling costs 100 and general administrative expenses 100.

		Year 1		Year 2		Total
Net revenue		0		4,000		4,000
Change in inventory of finished product and work in progress		1,600		(1,600)		0
Sum of operating revenues		1,600		2,400		4,000
Raw materials and consumables	800		800		1,600	
Wages and salaries	600		600		1,200	
Depreciation	400		400		800	
Sum of operating expenses		1,800		1,800		3,600
Operating profit or loss		(200)		600		400

If costs in year 1 had not been allocated to sales in year 2 (via the item change in inventory of finished product and work in progress), this would have resulted in a loss of 1,800.

In the presentation by nature of expense, expenses are subdivided by nature, such as raw materials and consumables, wages, depreciation and other operating expenses.

Presentation by function

Presentation by function is detailed in BMJ models F and J. These models are based on the revenue method. This means that the cost of sales is presented after net revenue. Expenses are then classified by function, such as selling costs and general administrative expenses. Cost types (e.g. wages and salaries and depreciation) are hereby allocated to the relevant functional areas. For example, production staff salaries will be part of cost of sales and sales staff salaries will be included in selling costs. In principle, the managing director's staff costs are to be classified as general administrative expenses.

Model J is less extensive in scope and therefore only allowed for small and medium-sized enterprises.

Example: Presentation by function

Applying this model to the previous example leads to the following profit and loss account.

		Year 1		Year 2		Total
Net revenue		0		4,000		4,000
Cost of sales		0		(3,200)		(3,200)
Gross margin		0		800		800
Selling costs	100		100		200	
General administrative expenses	100		100		200	
Sum of costs		200		200		400
Operating profit or loss		(200)		600		400

In practice, the following model sometimes occurs:

Revenue
Cost of sales
Gross margin

Wages and salaries
Social security expenses
Amortisation and depreciation of intangible and tangible fixed assets
Other changes in the value of intangible and tangible fixed assets
Impairment of current assets

Other operating expenses
Sum of operating expenses

This arrangement is a mixture of presentation by function and by nature of expense and is (therefore) not allowed. The cost of sales includes all elements belonging to the purchase or construction cost, including wage and depreciation costs attributable to revenue and attributable costs belonging to the category 'other operating expenses'. In the above arrangement, it is not clear whether those costs are included in the 'cost of sales', or in the relevant cost category.

In practice, this arrangement often includes only the value of goods in the 'cost of sales', and includes other costs attributable to revenue in the relevant cost category. In that case, the designation 'cost of sales' is not correct because that would only include the value of goods and not other elements belonging to the purchase or construction cost. A company that wants to present only the value of goods will in principle have to follow the arrangement by nature of expense (model E). Instead of the 'cost of sales' line, the cost categories 'cost of raw materials and consumables' (or 'cost of goods for resale') and 'cost of work contracted out and other external costs' will then be included. If there are no other operating revenues, it is permissible to add the line 'gross margin' in the model by nature of expense (as in the arrangement above), as subtotals may be inserted (Article 5(3) Decree on annual accounts format):

Revenue
Change in inventory of finished product and work in progress
Cost of raw materials and consumables
Work contracted out and other external costs
Gross margin

Wages and salaries
Social security expenses
Amortisation and depreciation of intangible and tangible fixed assets
Other changes in the value of intangible and tangible fixed assets
Impairment of current assets
Other operating expenses
Sum of operating expenses

Own performance measures such as gross operating profit or loss or EBITDA can be included in the notes to the profit and loss account. See paragraph 23.9.

23.5 Specific profit and loss account items

This paragraph details the principal items on the profit and loss account. As indicated in paragraph 23.1, it refers to separate chapters for a number of items.

Net revenue
The definition of net revenue is contained in Article 2:377(6) NCC and reads: 'net revenue is defined as the revenue from the supply of goods and services from the business of the entity less discounts and similar, and tax on revenue'.

As set out in Chapter 26, it is important in revenue recognition that this revenue also be enjoyed for the relevant company's own account. This means that amounts received by the company for third parties should not be recognised as revenue. As net revenue is a component of revenue, this provision also applies in full to the recognition of net revenue. For this reason, it is stipulated that tax on revenue is not part of net revenue.

Another important part of the definition is 'less discounts and similar'. The addition 'and similar' should only be interpreted restrictively (DAS 270.202). Thus, while the deductible items include rebates, sales bonuses and payment discounts, they do not include fees paid to company representatives, freight costs and other direct and indirect selling costs.

The term net revenue should be interpreted from the perspective of ordinary, recurring operating activities (DAS 270.201). Paragraph 26.8 discusses the term net revenue in more detail.

Cost of sales
This item occurs only when the model by function is used. The cost of sales includes direct costs and a fair share of indirect costs. Direct costs also include depreciation costs and impairment losses relating to production assets. Pursuant to Article 2:377 NCC, borrowing costs and similar costs must be recognised separately in the profit and loss account. This does not apply to interest recognised as part of the construction cost of qualifying assets (Article 2:388(2) NCC). Once these assets are depreciated, capitalised interest enters the profit and loss account as part of depreciation. If interest is capitalised, the notes should disclose the amount capitalised. This makes it possible to determine the annual total borrowing costs (= borrowing costs recognised in profit and loss account plus interest that is capitalised).

Other operating revenues
When choosing between recognition as net revenue or as 'other operating revenues', the relationship with the nature of the operating activities is a determining factor. Where revenue arises from ordinary, recurring operating activities, it is almost always recognised as net revenue. A number of examples to clarify the distinction between net revenue and other operating revenues have already been cited in the net revenue section. Another example relates to income from interest, which should be recognised as net revenue or financial income depending on the operating activities. Recognition as net revenue will occur for an investment company that receives interest from its investment portfolio. However, a company that receives interest into its regular bank account will recognise this revenue under financial income.

Cost of raw materials and consumables and other external costs
This item is prescribed in Article 2:377(3) NCC for the model by nature of expense. Based on the BMJ (Model E), this item should be broken down into 'cost of raw materials and consumables' and 'cost of work contracted out and other external costs'. In the case of a trading company, the designation 'cost of raw materials and consumables' will often be replaced by 'cost of goods for resale' (Article 5(2) Decree on annual accounts format).

In Model I of the BMJ, 'cost of raw materials and consumables' and 'cost of work contracted out and other external costs' are netted with operating revenues in the item 'gross margin'. Therefore, in our opinion, these costs are costs that both belong to the relevant category and are attributable to operating revenues. This means, for example, that general overheads are not included in 'costs of work contracted out and other external costs', even if they are external costs.

Wages and salaries
Both in the application of the model by nature of expense and in the application of the model by function, the financial statements must include information on the level of wages and salaries, pension costs and other social security expenses. For presentation by nature of expense, the various models already provide for this breakdown; in the model by function, this breakdown should be included in the notes.

Wages and salaries include the wage and salary costs of persons employed or having been employed during the financial year. Persons employed means those persons with whom a contract of employment existed during the financial year. Therefore, hired staff and recharged staff costs are not included in this category. Other staff costs, such as canteen costs and travel allowances, are mostly included in other operating expenses.

Social security expenses
Social security expenses include all contributions payable by the employer under social legislation and tax laws in respect of wages and salaries, as well as pension costs, less the share therein that has been borne by employees.

With regard to the pension costs to be recognised, please refer to Chapter 18.

Amortisation and depreciation of intangible and tangible fixed assets
For an explanation of amortisation and depreciation, see Chapters 5, 6 and 7. It is particularly important here that the level of amortisation and depreciation is determined consistently. The item for amortisation and depreciation should be broken down (in the notes) into amortisation and depreciation on intangible and tangible fixed assets.

Gains and losses on sale of tangible fixed assets
Gains on sale of tangible fixed assets are recognised as part of other operating revenues, while losses are recognised as part of other operating expenses; depending on factors such as size and frequency, recognition as an exceptional item may be preferable. In principle, it is wrong to net gains or losses on disposal against amortisation/depreciation

charges. That is because this recognition, which stems from the idea that a gain or loss on disposal is actually an adjustment to previous amortisation/depreciation charges, does not reflect the premise that the life has been estimated as best as possible and amortisation/depreciation is consistent. Incidentally, the consequence of such recognition would also be that the amortisation/depreciation charges in the profit and loss account would no longer match the amortisation/depreciation recorded in the movement schedules of intangible and tangible fixed assets.

Exceptions to the aforementioned method of recognition are regularly recurring sales of tangible fixed assets. Sales of these can be recognised as part of net revenue. Please refer to paragraphs 7.5 and 26.8.

Other impairment losses on intangible and tangible fixed assets
In addition to impairment losses from consistent depreciation, intangible and tangible fixed assets may also be subject to other impairments losses. Such impairment losses imply that the recoverable amount of the related asset is lower than its current carrying amount. The impairment losses and reversal of impairment losses must be broken down as regards intangible and tangible fixed assets. This breakdown may be included in the notes.

Other operating expenses
Other operating expenses are a residual operating expense.

Financial income and expenses
In general, interest is considered the principal financial income or expense. Chapter 27 discusses this in more detail. Other items that may be included under financial income and expenses are profits and losses of and dividends from participating interests. For this, see Chapter 9.

23.6 Presentation of changes in value

Article 2:384(7) NCC allows for the immediate inclusion in profit or loss of changes in the value of financial instruments measured at current value, other investments (other than financial instruments) and agricultural inventory for which there are frequent market quotations. Entities, other than banks, insurance companies or investment companies, may present changes in value that are recognised immediately in profit or loss in the manner described below.

Changes in the value of investments recognised immediately in profit or loss should be recognised as a separate item in the profit and loss account using the relevant designations of the items from BMJ Model S (unrealised changes in the value of investments) (DAS 270.512).

Changes in value immediately recognised in profit or loss of agricultural inventory for which there are frequent market quotations may be presented in the profit and loss account as follows (DAS 270.513):

- if model E of the BMJ is applied: as a separate item as part of the sum of operating revenues;
- if model F of the BMJ is used: as a separate item of gross margin.

23.7 Presentation of exceptional items

Exceptional items are those items designated in Article 2:377(8) NCC as income or expenses that are of exceptional magnitude or occur to an exceptional extent (DAS 270.0). Exceptional items should be disclosed separately and not netted by nature and extent for the purpose of analysis and comparability of profits and losses (DAS 270.404). This also applies to exceptional items included in multi-annual overviews. The considerations for this may be the type, magnitude or non-recurring nature of relevant events or transactions. Recognition as an exceptional item generally provides more insight into the structure of profit or loss and its development. This benefits comparability over several years. Examples of exceptional items include charges arising from a restructuring and the write-down of certain assets. They may also include disadvantages arising from nationalisations or expropriations and disadvantages resulting from capital destruction due to natural disasters.

If an exceptional item is included in several other items in the profit and loss account (for example, if restructuring costs consist of staff redundancy costs, fixed asset impairment losses and lease redemption costs), the total financial effect of the exceptional item should be disclosed as well as the method of its recognition. This should be done by providing a breakdown (including amounts) of the items under which the exceptional item has been recognised (DAS 270.404).

Pursuant to Article 2:377(7) NCC, the entity also explains the nature and extent of income and expenses to be allocated to another financial year.

The following articles from the Decree on annual accounts format are relevant to the presentation of exceptional items in the profit and loss account:

Article 5(3):	Subtotals may be inserted and named.
Article 6(1):	The order of the items is that of the chosen model.
Article 7(1):	A breakdown may be added to model items; they may be replaced by a breakdown.
Article 7(2):	Items may be inserted to the extent that their content is not covered by an item specified in the chosen model that is not marked 'other'.
Article 8(2):	Any continuous series of items in the profit and loss account not printed in capitals may be included in whole or in part in the notes, instead of in the profit and loss account, with repetition of the sum.

Goodwill amortisation and impairment loss
The presentation sometimes preferred by companies – that of presenting goodwill amortisation and impairment loss as low as possible in profit or loss before taxation and adding a line 'profit or loss before taxation before goodwill amortisation' in the profit and loss account – is not allowed, according to the Decree on annual accounts format (BMJ). The BMJ does allow subtotals to be inserted and named. However, it is contrary to the BMJ to change the order of the items. The order should conform to the model chosen from the BMJ (Article 6(1) BMJ). Amortisation of goodwill should therefore be presented as part of 'amortisation and depreciation of intangible and tangible fixed assets'. Any goodwill impairment loss should be presented as part of 'other changes in the value of intangible and tangible fixed assets'.

Restructuring charges
The method sometimes preferred by companies – of presenting restructuring charges as far as possible at the bottom of the profit and loss account – is often not possible. Often, the presentation violates Article 7(2) BMJ. Items may not be inserted if their content is covered by other items listed in the model that are not designated as 'other'. Thus, a restructuring charge consisting of staff redundancy costs, fixed asset impairment losses and other closing costs (contract redemption costs and the like) is quite often recognised as a separate item. This is not acceptable under Article 7(2) BMJ. Staff redundancy costs should be presented under staff costs, with any separate presentation under that heading also being acceptable. A separate line for fixed assets impairment losses is already available in the profit and loss account model by nature of expense. In the model by function, this item is in principle allocated to cost of sales, selling costs and/or general administrative expenses. If this is not practicable, these impairments should be recognised in a separate item as part of operating profit or loss (this is then permitted under Article 7(2) BMJ). Other closing costs are often not well covered by other items in the models and, for that reason, provided they are also material, can be presented separately as part of operating profit or loss. Of course, the notes to the profit and loss account can provide a breakdown of the total restructuring charge showing under which items it has been recognised.

Release of the revaluation reserve
If, with assets being measured at current value, the release of the revaluation reserve is credited to the profit and loss account, the release is presented separately in the profit and loss account pursuant to Article 2:390(4) NCC. Article 2:390(4) NCC requires the release of the revaluation reserve to be included in a separate item. This release should be presented on a separate line in the profit and loss account and not deducted from operating expenses or added to net operating profit. This line should be presented immediately before financial income and expenses as part of profit or loss before taxation (DAS 240.411). Under Article 5(3) BMJ, a subtotal may be inserted and defined. With the use of this option, the profit and loss account shows both the operating profit or loss before the realised revaluation and the operating profit or loss after the realised revaluation. See also paragraph 14.3.7.9.

23.8 Disclosure

The disclosure requirements of the law relate particularly to net revenue. Those requirements are detailed in Chapter 26. In addition to what is included in Chapter 26, we would also highlight the following disclosure requirements relating to the profit and loss account:

- the notes should include an explanation of amounts relating to special forms of activity, about which there may be uncertainty as to whether they should be included in net revenue (DAS 270.203);
- when presentation by function is used, the notes should disclose the total amount of wages and salaries and social security expenses recognised with separate disclosure of pension costs (see also paragraph 23.5) and depreciation. These are the items listed in Art 2:377(3) (e), (f) and (h) NCC (DAS 270.504);
- pension costs must be disclosed separately as part of social security expenses (Article 2:377(3) NCC);
- the average number of employees employed during the financial year must be disclosed, classified according to the organisational structure of the business (Article 2:382 NCC). The entity shall also state the number of employees working outside the Netherlands. The term employees includes all persons with whom the company has entered into an employment contract. In the case of part-time employees, it is reasonable to reduce the employees concerned to full-time equivalents. See also paragraph 18.2;
- exceptional items must be disclosed separately and unbalanced according to their nature and size (DAS 270.404). In addition, the law requires that the nature and amount of income and expenses to be allocated to another financial year be disclosed (Article 2:377(7) NCC);
- when it comes to other operating expenses, further disclosure is given if this item is substantial in relation to other expense items (DAS 270.503). The notes should be accompanied by a breakdown if necessary;
- if borrowing costs have been capitalised, this must be disclosed in the notes (Article 2:388(2) NCC). In the notes to the borrowing costs item, the amount capitalised during the year should be disclosed separately, as should the interest rate used in calculating the interest item to be capitalised. It is recommended that the notes disclose total borrowing costs under visible deduction of capitalised borrowing costs; and
- the financial statements must show the total of the development costs charged to profit or loss for the financial year, including amortisation of previously capitalised research and development costs (DAS 210.506).

23.9 Other details

Companies use a variety of financial performance measures. Examples include:

- EBIT (earnings before interest and taxes), also referred to as operating profit or loss after amortisation of goodwill;
- EBITA (earnings before interest, taxes and amortisation), also referred to as profit or loss before interest, taxes and amortisation of intangible fixed assets/goodwill. EBITA is seen as a measure for comparing operating profits and losses;
- EBITDA (earnings before interest, taxes, depreciation and amortisation), also referred to as profit or loss before interest, taxes, depreciation tangible fixed assets and amortisation of intangible fixed assets/goodwill. EBITDA is considered a measure of a company's cash-generating ability.

Use of the terms EBITA and EBITDA in the profit and loss account is not allowed under Article 6 of the Decree on annual accounts format. This stipulates that 'the order of items is that of the chosen model'. After all, when terms like EBITA and EBITDA are used in the profit and loss account, the presentation does not conform to that prescribed by the Decree on annual accounts format. Therefore, these terms can only be included in the notes to the profit and loss account.

23.10 Exemptions for medium-sized and small entities

Medium-sized and small entities may, pursuant to Article 2:397 NCC and Article 2:396 NCC respectively, suffice with a profit and loss account with notes limited to the following information:

- the main classification set out in Article 2:377(1) NCC;
- the breakdown by nature of expense as contained in Article 2:377(3) NCC or the breakdown by function as contained in Article 2:377(4) NCC;
- if breakdown by nature of expense is chosen, net revenue, change in inventory of finished product and work in progress, capitalised production for the own business, other operating revenues and costs of raw materials and

consumables and other external costs can be combined in the item 'gross operating profit or loss' (Article 2:377(3) NCC) or if breakdown by function is chosen, net revenue, cost of sales and other operating revenues can be combined in the item "gross operating profit or loss" (Article 2:377(4) NCC);
- disclosure by medium-sized entities of revenue development compared to last year in ratios. Small entities are exempt from this;
- separate disclosure of income and expenses (items k-o of paragraph 3 and items g-k of paragraph 4 of Article 2:377 NCC) from the relationship with group entities (Article 2:377(5) NCC);
- disclosure of income and expenses relating to previous financial years and of income and expenses that are of an exceptional magnitude or occur to an exceptional extent (Article 2:377(7) and (8) NCC).

Also, medium-sized entities have exemption from Article 2:380 NCC regarding segmentation of net revenue (pursuant to Article 2:397 NCC).

Medium-sized entities are not required to include the following information relating to the notes to the profit and loss account:

- further disclosure of 'other operating expenses', with a breakdown if necessary (DAS 270.503);
- they may, when using the presentation by function for the profit and loss account, limit the additional information with respect to the nature of expenses to disclosure of the total amount of wages and salaries and social security charges recognised in the profit and loss account with separate disclosure of pension costs (DAS 270.504).

Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the legal minimum') in the notes.

23.11 Significant differences from IFRS

Models
IFRS has only general rules regarding the presentation of the profit and loss account. IFRS does in fact recognise presentation by function and by nature of expense (IAS 1.99) but these are not further elaborated in prescribed models. DAS 270 ‘The profit and loss account’ – following the law and the Decree on annual accounts format – contains more detailed provisions on the order and breakdown of items in the profit and loss account.

24 Statement of comprehensive income

24.1 Introduction

The primary purpose of financial statements is to provide information about a company's financial position, profits and losses and changes in financial position that is useful in making economic decisions for users (the *Stramien*). A company's financial performance is partly determined by its financial profits and losses and the change in its financial position. The *Stramien* indicates that insight into financial profits and losses is primarily provided by the profit and loss account. No statement for the change in financial position is mentioned in the *Stramien*. In general, the cash flow statement and the equity movement schedule provide relevant information about the change in a company's financial position.

When measuring the financial performance of a company, it is important to distinguish between performance that is the result of the company's policies and performance that is actually not controllable by the company or is one-off in nature. There is a school of thought that argues that all economic effects should be reflected in the profit or loss, regardless of whether they are controllable or not: the so-called 'all inclusive' concept. Then there is another school of thought argues that the company's performance can only be measured on the basis of the profits and losses achieved through the company's policies. This school of thought advocates 'cleansing' the profit or loss of effects that cannot be influenced by the company. Dutch accounting rules reflect both approaches. Certain income and expenses may be excluded from the profit and loss account by recognising these items directly in equity. Examples include:

- recognising exchange differences on translating foreign operations in equity (DAS 122.404);
- recognising changes in the value of certain financial instruments; and
- recognising material errors (DAS 150.202).

There is no single measure of a company's financial performance. Instead, there are several measures, each of which can provide relevant information for assessing a company's financial performance. The user of financial statements will have to use various statements to understand the company's financial performance.

For a proper understanding of a company's performance in the reporting period, it is important that all income and expenses are presented in one statement, regardless of whether they are recognised in the profit and loss account or directly in equity. Therefore, a large entity must include a statement of comprehensive income in the financial statements if the entity prepares consolidated financial statements (DAS 265.101).

24.2 Statement of comprehensive income

The statement of comprehensive income includes all performances delivered by the group. The statement of comprehensive income must be included in the consolidated financial statements and consists of (DAS 265.201):

- the consolidated net profit or loss; and
- the totals of income and expenses recognised directly in equity.

If totals of income and expenses are presented net (i.e. after tax), the tax burden on the relevant items is disclosed (DAS 265.201).

The statement of comprehensive income includes only movements in equity, i.e. the comprehensive income attributable to the entity's shareholders. Movements in third-party interests in group equity are not included in this statement (DAS 265.102).

The statement should also include the comparative figures for the previous financial year (DAS 265.201). The statement of comprehensive income must be presented (DAS 265.202):

a. as a consolidated statement in addition to the consolidated balance sheet, profit and loss account and cash flow statement (this method of presentation is recommended) or as a note to group equity in the consolidated financial statements;
b. combined with the equity movement schedule in the consolidated financial statements; or
c. as an extension of the consolidated profit and loss account.

The cumulative effect of changes in accounting policies and the correction of material errors recognised directly in equity are not recognised as income and expenses. This also applies to movements in equity following transactions with shareholders, such as a share issue or a dividend payment. These items are therefore not included in the statement of comprehensive income (DAS 265.204).

It can happen that certain items are recognised in equity first and then at a later date finally recognised in the profit and loss account. An example is foreign currency translation differences on foreign operations which are recognised directly in equity, but which are recognised in the profit and loss account at the time of disposal of the foreign operations. Another example concerns the release of realised revaluations from the revaluation reserve to the profit and loss account. The statement of comprehensive income should be adjusted for these so-called 'recycled items', as they would otherwise be included twice. The nature of any adjustment arising from recycled items must be disclosed (DAS 265.205).

The examples of presentation of the statement of comprehensive income given below are taken from the appendix to DAS 265.

Example: Presentation of statement of comprehensive income (1)

As a consolidated statement supplementing the consolidated balance sheet, profit and loss account and cash flow statement, or as a note to group equity in the consolidated financial statements:

		Year 2		Year 1
Consolidated profit or loss after tax attributable to shareholders of the entity		3,500		6,000
Revaluation of tangible fixed assets	2,000		4,000	
Write-down/revaluation of financial fixed assets	(9,000)		18,000	
Foreign currency translation differences on foreign participating interests	(500)		2,000	
Realised revaluation charged to equity (1)	(500)		(1,000)	
Total direct movements in equity as part of group equity (2)		(8,000)		23,000
Comprehensive income		(4,500)		29,000

1. Note to be included with statement ('recycled item'): the revaluation is recognised in the profit and loss account upon realisation; the amount of the realised revaluation also forms part of the consolidated profit or loss after tax attributable to the shareholders of the entity as presented in the statement.

2. Possibly presented gross with the tax burden on it presented separately.

Example: Presentation of statement of comprehensive income (2)

Combined with the equity movement schedule in the consolidated financial statements:

			Year 2			Year 1
Equity as part of group equity at the beginning of the financial year			96,000			37,000
Consolidated profit or loss after tax attributable to shareholders of the entity		3,500			6,000	
Revaluation of tangible fixed assets	2,000			4,000		
Write-down/revaluation of financial fixed assets	(9,000)			18,000		
Foreign currency translation differences on foreign participating interests	(500)			2,000		
Realised revaluation charged to equity (1)	(500)			(1,000)		
Total direct movements in equity as part of group equity (2)		(8,000)			23,000	
Comprehensive income			(4,500)			29,000
Share issue		0			40,000	
Dividend payment to shareholders		(10,000)			(10,000)	

Total movements in equity in relation to shareholders	(10,000)	30,000
Equity as part of group equity at year-end	81,500	96,000

1. Note to be included with statement ('recycled item'): the revaluation is recognised in the profit and loss account upon realisation; the amount of the realised revaluation also forms part of the consolidated profit or loss after tax attributable to the shareholders of the entity as presented in the statement.

2. Possibly presented gross with the tax burden on it presented separately.

Example: Presentation of statement of comprehensive income (3)

As an extension of the consolidated profit and loss account:

		Year 2		Year 1
Consolidated profit or loss after tax attributable to shareholders of the entity		3,500		6,000
Revaluation of tangible fixed assets	2,000		4,000	
Write-down/revaluation of financial fixed assets	(9,000)		18,000	
Foreign currency translation differences on foreign participating interests	(500)		2,000	
Realised revaluation charged to equity (1)	(500)		(1,000)	
Total direct movements in equity as part of group equity (2)		(8,000)		23,000
Comprehensive income		(4,500)		29,000

1. Note to be included with statement ('recycled item'): the revaluation is recognised in the profit and loss account upon realisation; the amount of the realised revaluation also forms part of the consolidated profit or loss after tax attributable to the shareholders of the entity as presented in the statement.

2. Possibly presented gross with the tax burden on it presented separately.

24.3 Exemptions for medium-sized and small entities

Medium-sized and small entities are exempt from the inclusion of a statement of comprehensive income (DAS 265.101).

24.4 Significant differences from IFRS

Presentation
IAS 1 'Presentation of Financial Statements' does not include the option of combining the single 'Statement of comprehensive income' with the equity movement schedule ('Statement of changes in equity') or including it as a note to group equity. DAS 265 does offer these possibilities.

Changes in third-party interests in group equity are not included in the statement of comprehensive income under NL GAAP. They are included in the single 'Statement of comprehensive income' under IFRS.

Although there are differences in the presentation of items, the objective of the statement of comprehensive income under DAS 265 is otherwise similar to the objective of the single 'Statement of comprehensive income' under IAS 1.

Scope
Under NL GAAP, the statement of comprehensive income applies only to large entities. Under IFRS, all entities are required to prepare a single Statement of comprehensive income.

25 Cash flow statement

25.1 Introduction

A cash flow statement is a statement of the cash and cash equivalents that became available during the reporting period and the use that has been made of that cash and cash equivalents (DAS 360.101). A cash flow statement provides insight into cash inflows and outflows classified by different activity categories and thus adds value, as it provides information that is not otherwise apparent from the financial statements.

Large and medium-sized entities are required to prepare a cash flow statement (DAS 360.104). However, this requirement does not apply to an entity that is a direct or indirect 100% subsidiary of an entity that includes., by another entity preparing an equivalent cash flow statement in its financial statements. Examples of an equivalent cash flow statement are a cash flow statement prepared in accordance with IFRS or US GAAP. The reason for this exemption is that for such an entity, financing and cash management is usually integrated into the group policy. Furthermore, there are no minority shareholders in this situation. The entity must then indicate in the notes where those consolidated financial statements can be obtained (e.g. an internet address). However, such entities are recommended to prepare a cash flow statement (DAS 360.104). The requirement to disclose where the consolidated financial statements can be obtained could be interpreted as if the consolidated financial statements must already be available to qualify for the exemption of DAS 360.104. Given the rationale for this exemption, we believe this is not the case, provided there is a legitimate expectation that the consolidated financial statements with an equivalent cash flow statement will be published within the legal deadline for publishing those consolidated financial statements.

In our opinion, the exemption of DAS 360.104 can also apply under certain conditions if the entity is acquired during the financial year. The financing and cash management of the entity should then be integrated into the policy of the old and new group respectively, both before and after the acquisition (i.e. throughout the financial year). Of course, the other conditions must also be met in this case. So both before and after the acquisition, capital should be provided in full, directly or indirectly, by the respective head of the groups who also prepare an equivalent consolidated cash flow statement.

A cash flow statement need not be prepared by entities that make use of Article 2:403 NCC (group exemption) when preparing their financial statements and by entities that can be designated as pure intermediate holding companies (DAS 360.104).

If consolidated financial statements are prepared, the cash flow statement is included on a consolidated basis. A cash flow statement on a company-only basis only needs to be prepared in the absence of consolidated financial statements (DAS 360.106).

25.2 Purpose and function of the cash flow statement

A cash flow statement performs a different function from a balance sheet and a profit and loss account. The balance sheet reflects the financial position at the beginning and end of the reporting period. The profit and loss account shows the profit or loss realised during the reporting period. Because a company's reported profit or loss and cash flows can differ widely in the short term, the cash flow statement provides useful additional information. After all, going concern of a company is only guaranteed if positive cash flows are generated on a permanent basis.

Therefore, guaranteed going concern cannot be taken for granted just because a company is making a profit. Even profitable companies can, under certain circumstances, run into financing problems such that going concern is at risk. Think of fast-growing digital services companies that need to invest heavily in expanding technical capacity and recruiting and retaining new customers for further growth.

There is therefore a need for a statement that provides insight into the size and composition of cash inflows and outflows and thus the company's ability to generate positive cash flows from operations. Such insight is provided by the cash flow statement.

A cash flow statement, in conjunction with the balance sheet and profit and loss account, helps provide insight into:

- the financing of the entity's activities;
- liquidity;

- solvency; and
- the quality of profit or loss obtained.

In addition, a cash flow statement provides insight into an entity's ability to generate cash flows. This more forward-looking function does have the caveat that it only exists if and to the extent that historical cash flows can contribute to the understanding of cash flows in future periods (DAS 360.103).

25.3 Form and content of the cash flow statement

The cash flow statement should be prepared in accordance with the specific provisions included in DAS 360 on the content of the cash flow statement and the notes to the cash flow statement (DAS 360.105).

25.3.1 Cash and cash equivalents

For the purpose of preparing a cash flow statement, cash and cash equivalents means (DAS 360.102):

- cash;
- demand deposits; and
- cash equivalents.

Cash includes cash on hand, balances in bank and giro accounts, bills of exchange, and cheques (DAS 940). Demand deposits are deposits that are immediately available, possibly at the expense of interest income. Cash equivalents are highly liquid financial assets that can be easily and readily converted into cash without restrictions and with minimal risk of value changes (DAS 360.0). For example, money market funds can be considered cash equivalents if they are highly liquid and can be easily converted into cash without significant risk of value changes.

Current bank debt is generally considered part of financing activities. In this case, current bank debt is not deducted from the cash and cash equivalents. The Dutch Accounting Standards Board has clarified that, under certain conditions, current bank debt may be included in the definition of cash and cash equivalents. This occurs when debit balances in bank accounts are an integral part of a company's daily cash management and these balances are payable on demand. This may be the case, for example, if a contract is in place with a bank, whereby debit and credit balances in different currencies are translated by the bank to a single balance in a single currency, without actually being converted into that single currency (notional cash pooling). Such current account positions are often characterised by the fact that the account balance frequently fluctuates between positive and negative. The term 'often' is used by the Dutch Accounting Standards Board to indicate that 'frequent fluctuations of an account balance between positive and negative' are an indication that a current account position is an integral part of an entity's cash management. Cash management involves managing cash and cash equivalents with the aim of meeting short-term obligations. When assessing whether a bank debt is an integral part of cash management, the facts and circumstances must be considered. In our opinion, this means that if the balance is always negative, it is not a case of cash management but of financing activities. Payments and receipts on the relevant bank account should then be accounted for as a cash flow based on the nature of the cash flows (such as receipts from customers). The balance of the payments and receipts then does not result in a change in cash and cash equivalents, but constitutes a financing cash flow (drawdown/repayment of the bank debt).

25.3.2 Presentation of the cash flow statement

The cash flow statement is classified into three different activity categories (DAS 360.201):

- cash flows from operating activities;
- cash flows from investing activities; and
- cash flows from financing activities.

The advantage of classification into activity categories is that it provides a good insight into the underlying sources that caused the cash inflows and outflows.

25.3.3 Gross or net cash flows

For a proper understanding of the financial policy, it is important to include gross cash flows when presenting cash flows. This means that amounts received and paid are shown separately and therefore not netted. An example relates to the separate disclosure of cash and cash equivalents obtained from new loans taken out and expenditures consisting of repayments in the year on these new loans and loans already taken out in previous years.

Cash and cash equivalents receipts and cash and cash equivalents expenditures by group of transactions and events are presented separately (DAS 360.202). In addition, net cash flow is shown by type of activity (operating, investing and financing activities). This is the balance of receipts and expenditures for that activity.

25.3.4 Cash flows from operating activities

General
Operating activities consist of transactions and events that mostly lead directly to revenues and expenses in the profit and loss account. Examples of cash flows from operating activities are (DAS 360.209):

- receipts for sale of goods and provision of services;
- receipts arising from royalties, commissions and the like;
- expenditures for the purchase of goods and services;
- expenditures for the production process;
- expenditures related to payments of operational lease instalments;
- receipts and expenditures arising from interest;
- dividend receipts; and
- receipts and expenditures related to income taxes.

Receipts for sales of goods and provision of services are receipts in respect of cash sales or in respect of sales on account. Receipts relating to sales on account do not concern the sale itself, but receipts from debtors. Expenditures for purchases of goods and services and expenditures for the production process usually involve payments to creditors for purchases of goods for resale or for costs of raw materials and consumables, costs of subcontracted work or other operating expenses. They also include the payment of wages and salaries, social security expenses and pension costs to employees (net wages), implementing bodies (e.g. unemployment [WW] and health insurance [ZFW] contributions), Tax Administration (payroll tax) and pension funds (pension contributions).

It is recommended that a separate subtotal be included for cash flow from operational activities when presenting cash flows from business activities. Cash flow from business activities relates to all operational receipts and expenditures excluding cash flows arising from interest, dividends and income taxes (DAS 360.216).

Two methods exist for presenting cash flow from operational activities: the direct and the indirect method (DAS 360.210). The difference between the direct and indirect methods actually relates only to the method of determining the cash flow from business activities. This is because cash flows arising from interest, dividend received and income taxes should always be determined using the direct method (see paragraph 25.3.7). This is illustrated in Annex 1 which includes a detailed example of a cash flow statement using the direct method and using the indirect method. That example shows that only the presentation of cash flow from business activities differs.

An argument for using the direct method is that it shows actual cash inflows and outflows (i.e. in popular terms, the movements in the company's cash and bank ledger). This makes it clear how cash and cash equivalents are generated by the company. Another advantage of the direct method is that it facilitates comparison of the operational cash flows of different companies. The effects of different measurement basis and depreciation methods do not play a role in the direct method. The direct method is therefore more understandable than the indirect method.

An argument for using the indirect method is that it shows the differences between operating profit or loss and cash flow from business activities. This reveals the source of cash flow from business activities. Based on this information, an opinion can be formed on the quality of profit and a better understanding is obtained of the company's ability to generate positive cash flows from operations.

A cash flow statement using the direct method most closely matches actual cash flows. In practice, we see that despite this, the indirect method is mostly used.

Direct method
Under the direct method, operating cash receipts and cash expenditures are presented as such.

Annex 1 to this chapter contains an example of a cash flow statement using the direct method (extracted from DAS 360), where the following items are included in the cash flow statement:

- receipts from customers;
- payments to suppliers and employees.

The balance of these constitutes cash flow from business activities. The item payments to suppliers and employees includes payments to employees, implementing bodies, Tax Administration and pension funds related to personnel costs.

In the case of companies liable for turnover tax, there are also cash flows arising from turnover tax. Two alternatives are provided for presenting cash flows arising from turnover tax under the direct method (DAS 360.215). The first alternative presents gross cash flows, i.e. receipts from customers including turnover tax to be paid and payments to suppliers including turnover tax to be claimed back. The balance of the turnover tax to be paid and received, and the net payment to the tax authorities, is then recognised as an expenditure. Under the second alternative, all receipts and expenditures arising from turnover tax are netted under expenditures. In DAS 360.215, it is not specified under which item this expense should be recognised. In the example included in the appendix of DAS 360, this is done under the item 'payments to suppliers and employees'. This is logical to the extent that an (interim) subtotal of the cash flow from operating activities (see example in the appendix of this chapter) is then cleansed of the effect of turnover tax.

For this reason, we see that in practice the second alternative is preferred, because receipts and expenditures arising from turnover tax do not increase or decrease economic potential. A net presentation therefore provides a better insight into the company's ability to generate cash flows from business activities. Applying this alternative, along with presenting the (net) payment on a separate line (for example, before or after the item of income taxes paid) is our preference. Fluctuations in the turnover tax payable/reclaimable item then do not disrupt the regular subtotals such as cash flow from business activities.

The information for presenting cash flows from operating activities under the direct method can be obtained in two ways (DAS 360.211):

1. derived directly from the accounts of the entity (i.e. from all cash and bank movements of the company);
2. derived from the accounts through appropriate adjustment of net revenue, cost of sales and other components of the profit and loss account (i.e. from the company's trial balance, with adjustments being made).

It is recommended that a reconciliation between operating profit or loss and cash flow from business activities be provided when applying the direct method (DAS 360.211). In fact, it provides insight into the relationship between operating profit or loss and cash flow from business activities.

Example: Direct method

Under the direct method, items in the cash flow statement can be derived from the accounts by appropriately adjusting the various components of the profit and loss account. The item receipts from customers can be derived from the accounts as follows:

Net revenue
+ other operating income
- increase/+ decrease in trade receivables (excluding VAT and before deduction of provision for bad debts)
- write-down of uncollectible trade receivables
- increase/+ decrease in amounts to be received
+ increase/- decrease in advance receipts
+ increase/- decrease in amounts to be paid arising from credit notes

Under other operating income, amounts to be received and advance receipts, only those items related to operational activities should be selected.

The item payments to suppliers can be derived from the accounts as follows:

Cost of raw materials and consumables
+ cost of subcontracted work and other external charges
+ other operating expenses (excluding other personnel costs)
- addition to/+ release of provision for bad debts
- addition to/+ release of provision for obsolete inventory
- addition to/+ release of other provisions (e.g. provision for major maintenance)
+ payments charged to other provisions (e.g. provision for major maintenance)
- increase/+ decrease in trade payables (excl. VAT)
- increase/+ decrease in amounts to be paid
+ increase/- decrease in prepayments
+ increase/- decrease in credit notes receivable
+ increase/- decrease in inventory (before deduction of provision for obsolete inventory)
– increase/+ decrease in VAT to be paid
+ increase/- decrease in VAT to be claimed back

Under other operating expenses, other provisions, amounts to be paid and prepayments, only those items related to operational activities should be selected.

The item payments to employees can be derived from the accounts as follows:

Wages and salaries
+ social security expenses
+ pension costs
+ other personnel costs
- increase/+ decrease in net wages payable
- increase/+ decrease in holiday pay payable
- increase/+ decrease in social security charges to be paid
- increase /+ decrease in payroll taxes to be paid
- increase /+ decrease in pension contributions to be paid
- addition to/+ release of pension provision
+ payments charged to pension provision

Indirect method
Under the indirect method, cash flow from operating activities is derived from profit or loss. To this end, for the presentation of cash flow from operating activities, the reported profit or loss is adjusted for (DAS 360.212):

- profit and loss account items that do not affect receipts and expenditures in the same period;
- movements in provisions, accruals, inventory, trade receivables and trade payables; and
- profit and loss account items whose corresponding receipts and expenditures do not form part of the operational activities.

Profit and loss account items that do not affect receipts and expenditures are costs that are not expenditures (e.g. depreciation and additions to provisions) and revenues that are not receipts (e.g. rents to be received).

Examples of movements in provisions and accruals include expenditures that are not costs (e.g. payments of maintenance expenditures charged to the provision for major maintenance) and receipts that are not revenues (e.g. subscription fees received in advance).

Adjustments for profit and loss account items whose receipts and expenditures are not part of operational activities consist of a shift between the different activity categories of the cash flow statement. An example of income recognised in the profit and loss account that is not part of operational activities could be a gain on disposals. At the time of sale, the entire sales revenue – including the gain – should be recognised under cash flows from investing activities.

Also, the movement in current assets and current liabilities should be properly analysed for items that are not part of business activities. Examples include investment payables, receivables arising from disposals and also receivables and payables to related parties that are of a financing nature. The movements in these items should be adjusted to investing cash flows and financing cash flows respectively, and not to operating cash flows.

The reported profit or loss to which these adjustments are made is preferably the operating profit or loss (DAS 360.212). However, use of profit or loss before tax or profit or loss after tax is also permitted. The Dutch Accounting Standards Board's preference for operating profit or loss is in line with the recommendation to include a separate subtotal for cash flow from business activities. As income and expenses arising from interest, dividend received and income taxes are not part of operating profit or loss, this method of presentation does not require adjustments to the derivation of operating profit or loss to cash flow from business activities for these items. After cash flow from business activities, actual receipts and expenditures arising from interest, dividend received and income taxes are included in the statement of cash flow from operating activities. So, in the cash flow statement using the indirect method, those cash flows are actually shown using the direct method.

Example: Indirect method

Under the indirect method, cash flow from business activities is determined as follows:

Operating profit or loss
+ amortisation and depreciation of intangible and tangible fixed assets
+ other impairment losses on intangible and tangible fixed assets
+ increase/- decrease in provisions
- increase/+ decrease in trade receivables
- increase/+ decrease in inventory
+ increase/- decrease in trade payables
- increase/+ decrease in other operating receivables and operating prepayments and accrued income (excluding interest and dividend)
+ increase/- decrease in other operating debt and operating accruals and deferred income (excluding interest and dividend)
+ increase/- decrease in taxes and social security contributions payable (insofar as related to business activities and excluding income taxes)

Comparison with the example of the direct method shows that under the indirect method, the items in the cash flow statement can be derived relatively simple from the balance sheet and profit and loss account and accompanying notes. Derivation of the cash flow statement items under the direct method requires more details from the accounts, which makes this method more laborious than the indirect method. Therefore, in practice, the indirect method is usually used.

Annex 1 to this chapter contains an example of a cash flow statement using the indirect method.

25.3.5 Cash flows from investing activities

Investment activities refer to investments in and disposals of intangible, tangible and financial fixed assets (DAS 360.217). Investment activities also include temporary investments in current assets. Examples of cash flows from investing activities are:

- expenditures for capitalised development costs;
- expenditures for the acquisition of land, buildings, machinery, concessions and participating interests;
- expenditures for self-constructed tangible fixed assets;
- receipts arising from the sale of fixed assets (unless these are recognised as net revenue because they are regular sales, see paragraph 26.5);
- expenditures and receipts arising from the provision and repayment of long-term loans issued by the entity; and
- expenditures and receipts arising from the investment in securities, not highly liquid on short term.

In addition, expenditures arising from interest capitalised under fixed assets are included in cash flows from investing activities (DAS 360.218).

25.3.6 Cash flows from financing activities

Financing activities comprise the activities to finance operating and investing activities. Financing activities affect the size and composition of equity or liabilities (DAS 360.220). Examples of cash flows from financing activities are:

- receipts arising from the issue of shares;
- expenditures related to the repurchase of own shares;

- receipts or repayments arising from drawn bond loans, private loans, mortgage loans, loans with related parties and other short-term and long-term loans;
- expenditures to repay the loans;
- expenditures by a lessee for the reduction (repayment) of the outstanding liability for a finance lease; and
- receipts and expenditures on current account banks or current account with related parties of a financing nature.

The receipt arising from a sale and financial leaseback transaction is also presented as a cash flow arising from financing activities (DAS 360.207).

25.3.7 Interest, dividend and income taxes

Interest
Cash flows arising from interest received are included either in cash flows from operating activities or in cash flows from investing activities (DAS 360.213). It is clear that financial institutions that aim for an interest margin in the ordinary course of their business operations (such as banking), consider this interest as part of their operating activities.

Cash flows arising from interest paid are included either in cash flows from operating activities (see reasoning above) or in cash flows from financing activities (DAS 360.213). Interest included in lease instalments paid under finance leases is also classified as an interest payment (DAS 360.213).

Dividend
Cash flows arising from dividend received are presented either under cash flows from operating activities or under cash flows from investing activities (DAS 360.213). For participation and investment entities, it makes sense to classify the received dividends as part of operating activities. After all, their business model is aimed at achieving direct and indirect returns from investments and participations. For a company with a different primary business that, for example, invests excess cash in an equity fund and receives dividends from it, it makes more sense, in our opinion, to classify these receipts as an investing cash flow.

Dividends paid are preferably recognised under cash flows from financing activities (DAS 360.213). Dividends paid to shareholders of the company and to holders of minority interests are presented separately (DAS 360.221). In this way, insight is gained into the flow of dividends that go to the company's own shareholders and the dividends that have gone to minority shareholders.

Income taxes
Receipts and expenditures arising from income tax are recognised in operating activities, except to the extent that they are practically attributable to investing and financing activities. For example, a tax expenditure associated with a gain on assets sold is presented under investing activities (DAS 360.214).

25.4 Cash flow statement concerns

Purchase and sale of participating interests
If participating interests are purchased, the purchase price must be recognised as part of investments in financial fixed assets or group entities in the cash flow statement. On sale of participating interests, the selling price should be recognised in the cash flow statement in a manner similar to disposal of financial fixed assets or group entities. The acquisition or disposal of a company through an asset-liability transaction is also treated as an investment or disposal of financial fixed assets or group entities, respectively. It follows from the above that goodwill paid for the participating interest is not recognised separately in the cash flow statement.

In addition, when group entities are purchased and sold (consolidated participating interests), the cash and cash equivalents present in these companies is recognised in the cash flow statement. This cash and cash equivalents should be deducted from the purchase and selling price respectively (DAS 360.219). Separate disclosure as part of the reconciliation between net cash flow and balance sheet movement of cash and cash equivalents is no longer allowed.

Example: Purchase and sale of participating interests

On 1 April, BV M, a private limited liability entity, buys all the shares of BV D for an amount of 200. The company-only balance sheet of BV D at the time of acquisition is as follows:

		1 April
	D	C
Tangible fixed assets	200	
Inventory	50	
Accounts receivable	80	
Cash	20	
Equity		180
Provisions		20
Non-current debt		60
Accounts payable		90
	350	350

It is assumed that the fair value of the assets and liabilities of BV D at the time of acquisition is equal to the carrying amount of those assets and liabilities.

This acquisition balance sheet shows that 20 goodwill has been paid. Financing of the purchase of BV D took place partly by issuing shares to the seller of BV D worth 80 and partly by raising a long-term loan in the amount of 90. The balance of 30 was paid from available cash.

The company-only balance sheet of BV M after and before purchase of the shares of BV D is as follows:

		1 April After purchase of participating interest		1 April Before purchase of participating interest
	D	C	D	C
Goodwill	20			
Tangible fixed assets	450		450	
Financial fixed assets	180			
Inventory	100		100	
Accounts receivable	200		200	
Cash	20		50	
Equity		430		350
Provisions		50		50
Non-current debt		240		150
Accounts payable		250		250
	970	970	800	800

The consolidated balance sheet of BV M after and before purchasing the shares of BV D is as follows:

		1 April After purchase of participating interest		1 April Before purchase of participating interest
	D	C	D	C
Goodwill	20			
Tangible fixed assets	650		450	
Inventory	150		100	
Accounts receivable	280		200	
Cash	40		50	
Equity		430		350
Provisions		70		50
Non-current debt		300		150
Accounts payable		340		250
	1,140	1,140	800	800

In the consolidated cash flow statement of BV M, the cash present (20) in the acquired group entity (BV D) is deducted from the purchase price of BV D to the extent it has been paid in cash (200 – 80 = 120) (DAS 360.219).

Cash flow from investing activities		
Acquisition of group entities	(100)	
Cash flow from investing activities		(100)
Cash flow from financing activities		
Receipt from long-term loans	90	
Cash flow from financing activities		90
Net cash flow/decrease in cash		(10)

Example: Group entity becomes joint venture

Company A BV entered into a joint venture contract, under which it was agreed that the joint venture partner would acquire a 50% interest in the group entity, of which A BV previously had full ownership. This former group entity, which issued new shares to the joint venture partner for cash, had a current bank debt (classified as part of cash and cash equivalents) at the time of termination of the group relationship. How should the change in status from group entity to joint venture be accounted for in the consolidated cash flow statement, assuming the joint venture is measured at net asset value?

Although the group retains a 50% interest, the joint venture is no longer part of the group and the cash flow should no longer be consolidated. The transaction is a deemed disposal. According to DAS 360.219, on disposal of a group entity by a group, the amount received for the disposal of the 50% interest plus or minus the cash transferred (in this case the current bank debt) should be presented under cash flow from investing activities. In this case, no receipts arising from disposal need to be recognised because the joint venture issued new shares and received the cash for this. A itself did not receive any cash on account of the transaction. Thus, the amount of the current bank debt of the group entity at the time of disposal by the group should be recognised as positive cash flow from investing activities in the consolidated cash flow statement.

Package deals and non-cash transactions

Package deals and non-cash transactions cannot be recognised in the cash flow statement according to their constituent components (DAS 360.206). However, the nature and constituent components of such transactions must be disclosed in the notes to the cash flow statement.

An example of a package deal could be the purchase of a property at a higher than market price, together with a low-interest loan received from the seller. Non-cash transactions can include, for example, the acquisition of tangible fixed assets under a finance lease contract, the acquisition of participating interests financed by issuing shares to the seller of the participating interest, the conversion of liabilities into equity in case of a convertible bond loan or the distribution of stock dividend. If these non-cash transactions were included in the cash flow statement according to their constituent components, notional receipts and expenditures would be disclosed. For example, under finance leases, a notional receipt from financing activities and a notional expenditure arising from investing activities would be shown as cash flows.

Factoring and reverse factoring

In the case of factoring, outstanding invoices are paid earlier by the bank acting as a factor. When trade receivables are sold, operating cash flows will arise when the trade receivables are derecognised.

Things get trickier with *reverse factoring,* also known as *supply chain financing* or *supplier finance arrangements*, because in that case trade payables are pre-financed by the bank. That is, after the customer approves the purchase invoices, the bank pays the suppliers directly. The customer then pays the bank. Depending on whether the terms of the debt change in a material sense, the following situations can be distinguished in reverse factoring (see paragraph 21.5.2):

- a trade payable is still recognised on the balance sheet. In this case, the payment to the bank by the customer is presented in the cash flow statement as an operating cash flow, in this case as the payment of a trade payable; or
- the trade payable is replaced by a bank debt on the balance sheet. In this case, the payment to the bank should be presented in the cash flow statement as a financing cash outflow. The previous conversion of the trade payable into bank debt is a non-cash transaction that needs to be disclosed in order to properly interpret payments to suppliers and operating cash flow, respectively, in the cash flow statement.

Finance leases
In the case of finance leases, at the inception of the lease contract, the notes to the cash flow statement indicate the amounts for which assets and lease liabilities are recognised on the balance sheet but not in the cash flow statement (DAS 360.207).

Incidentally, the payment of lease instalments during the term of the lease contract does result in the recognition of cash flows in the cash flow statement. Finance lease instalments are divided into a repayment component and an interest component. The repayment component is presented under cash flows from financing activities. The interest component is presented in accordance with the choice of accounting policy for cash flows arising from interest paid, i.e. either under cash flows from operating activities or under cash flows from financing activities (DAS 360.207/213). The receipt arising from a sale and financial leaseback transaction is presented as cash flow arising from financing activities.

Under operating leases, lease instalments are recognised in full under cash flows from operating activities.

Perhaps unnecessarily, we would remind you that asset revaluations and unrealised exchange and translation differences are not recognised as (notional) cash flows in the cash flow statement (DAS 360.205). Moreover, DAS 360 does not mention that asset revaluations or unrealised exchange and translation differences should be disclosed.

Foreign currency
Foreign currency cash flows are translated at the exchange rate at the time of the transaction or at an average exchange rate. When the indirect method is applied, cash flows from operating activities may be translated at the exchange rate used in the profit and loss account translation (DAS 360.203).

The difference between the total net cash flow reported in the cash flow statement and the movement of cash recognised on the balance sheet resulting from changes in exchange rates is disclosed separately in the cash flow statement. This disclosure is made as part of the reconciliation between net cash flow and balance sheet movement of cash and cash equivalents (DAS 360.203).

Example: Foreign currency

BV A, a private limited liability entity, has cash on 1 January consisting of EUR 100 and USD 100. The exchange rate at 1 January is USD 1 = EUR 1. BV A has therefore included an amount of EUR 200 for cash on its balance sheet.

No activities take place during the year. BV A's cash at 31 December still consists of EUR 100 and USD 100. On 31 December, the exchange rate has become USD 1 = EUR 1.2, so BV A has recognised an amount of EUR 220 for cash on its balance sheet.

BV A's cash flow statement (in EUR) is as follows:

Net cash flow	0
Exchange rate and translation differences	20
Increase in cash and cash equivalents	20

Example: Foreign currency cash flows

Company A, whose functional currency is the euro, buys a machine for USD 100,000. A recognises this purchase in its accounts at the time of delivery of the machine. On account of the exchange rate at that time (USD 1.25 = EUR 1), the machine is recognised for EUR 80,000 in A's accounts. The invoice is paid 30 days later through the bank. At that point, EUR 82,000 is needed for payment. The exchange rate difference of EUR 2,000 is recognised in the profit and loss account.

The purchase of the machine is recognised in the cash flow statement as cash flow from investing activities in the amount of EUR 82,000. When the indirect method is used, one of the adjustments to net income to determine operating cash flow will be the adjustment arising from the exchange rate difference of EUR 2,000.

If the machine purchased was intended for trading, the purchase should have been accounted for under operating cash flow (and not under investing cash flow). According to DAS 360, an outflow of cash and cash equivalents arising from the purchase of the machine in the amount of EUR 82,000 should then be recognised under operating cash flow in the cash flow statement. In the profit and loss account, costs of EUR 80,000 should be recognised in expenses and the exchange rate difference of EUR 2,000 as exchange rate loss. As a result, the total EUR 82,000 is recognised in the profit and loss account and is fully recognised in the net profit or loss. As a result, no adjustment for the exchange rate difference of EUR 2,000 then needs to be made in the cash flow from operating activities determined using the indirect method.

Hedging instruments
As part of a company's financial policy, financial instruments such as forward contracts, options, swaps and the like are sometimes used to hedge positions taken. The related cash flows should be presented in the same category as the cash flows associated with the hedged item (DAS 360.204).

Cash flows arising from exceptional items
Cash flows arising from exceptional items in the profit and loss account are part of cash flows from operating, investing or financing activities depending on their nature (DAS 360.208).

Investments
Investments are recognised in the cash flow statement in the period of actual payment. If an asset has been recognised on the balance sheet as an investment, but has not yet been paid for by the balance sheet date, an 'investment creditor' arises. This should be distinguished from trade creditors, which relate to operating activities (amounts payable for the purchase of goods and services). This also means that when deriving cash flow from operating activities from operating profit or loss, *no* adjustment should be made for the movement in investment creditors or investments to be paid.

Disposals
Cash flow from investing activities should include actual receipts arising from disposals. Disposals are therefore not recognised at carrying amount in the cash flow statement. Also, the gain or loss on the disposal – included in the profit or loss for the financial year – must be eliminated from cash flow from operating activities. To this end, in the derivation of cash flow from operating activities from operating profit or loss, a separate line in the cash flow statement is included for the adjustment of gain or loss on disposal.

25.5 Notes to the cash flow statement

General
A cash flow statement should be accompanied by notes (DAS 360.301). The notes focus on those aspects that are important for a proper understanding of the cash flow statement. Paragraph 25.4 has already indicated that in the case of package deals and non-cash transactions, the notes to the cash flow statement should disclose the nature and constituent components of such transactions.

In the case of finance leases, at the inception of the lease contract, the notes to the cash flow statement indicate the amounts for which assets and lease liabilities are recognised on the balance sheet but not in the cash flow statement (DAS 360.207).

Cash and cash equivalents
If the term 'cash and cash equivalents' in the cash flow statement differs from the term 'cash' on the balance sheet, a numerical reconciliation between the two terms should be included in the notes to the cash flow statement (specifying the components of the cash and cash equivalents) (DAS 360.302).

Furthermore, it is recommended that the amount of cash and cash equivalents on the reporting date attributable to minority interests be disclosed separately (DAS 360.305). A similar recommendation applies to the disclosure of the amount of cash flows attributable to minority interests from operating, investing and financing activities.

Balance sheet movements
If significant differences occur between movements in balance sheet items as shown in the cash flow statement on the one hand, and on the other hand movements in balance sheet items as shown on the balance sheets at the beginning and end of the reporting period, it is recommended that these be disclosed (DAS 360.303). Changes in balance sheet items are shown in the cash flow statement when the indirect method is used or in the recommended reconciliation statement between operating profit or loss and cash flow from business activities when the direct

method is used. Significant differences will arise, for example, if purchases and sales of group entities are recognised in the manner prescribed in paragraph 25.4. In that case, a numerical reconciliation between the movements in balance sheet items according to the cash flow statement and according to the opening and closing balance sheet seems appropriate. If the differences are caused by translation differences, a disclosure to this effect will suffice.

Example: Balance sheet movements (1)

For example, a statement disclosing significant differences between movements in balance sheet items as shown in the cash flow statement on the one hand, and on the other hand movements in balance sheet items as shown on the balance sheets at the beginning and end of the reporting period, might look as follows:

	Balance sheet movements	New consoli-dations	Deconso-lidation	Exchange rate differences	Share of profit from participa-ting interest	Cash flow statement
Tangible fixed assets	1,000	200	50	100		1,250
Financial fixed assets	500	100	40	50	100	710
Inventory	700	300	30	60		1,030
Receivables	600	300	40	20		880
Cash	200	100	40	20		280
Total assets	3,000	1,000	200	250	100	4,150

	Balance sheet movements	New consoli-dations	Deconso-lidation	Exchange rate differences	Share of profit from participa-ting interest	Cash flow statement
Equity	1,200	400	100	120	100	1,720
Provisions	600	200	10	50		840
Non-current debt	200	300	50	10		460
Current debt	1,000	100	40	70		1,130
Total liabilities and equity	3,000	1,000	200	250	100	4,150

Where there are significant differences between items in the cash flow statement and movement schedules on assets and liabilities, it is recommended that these be disclosed (DAS 360.301). This can occur with investments and disposals that have already resulted in movements of assets and liabilities but not yet in cash outflows and inflows, respectively.

Example: Balance sheet movements (2)

For example, a statement explaining significant differences between items in the cash flow statement and movement schedules on assets and liabilities might look as follows:

Investments in tangible fixed assets as per movement schedule on tangible fixed assets	1,500
Increase in investment payables	1,000
Investments tangible fixed assets as per cash flow statement	500

Exceptional receipts and expenditures
Extraordinary receipts and expenditures must be disclosed in more detail unless these cash flows are already apparent as such from the cash flow statement (DAS 360.304). Examples of exceptional receipts and expenditures include:

- cash flows arising from exceptional items in the profit and loss account;
- cash flows related to the company's expansion; and
- cash flows classified under operating activities but also of a financing nature, such as receipts and expenditures arising from factoring.

Comparative figures
Like the balance sheet and profit and loss account, the cash flow statement is provided with comparative figures for the previous financial year (DAS 360.107).

Management board report
It is recommended that the management board report also elaborate on the data presented in the cash flow statement (DAS 360.301).

25.6 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

Small entities are exempt from preparing a cash flow statement.

25.7 Significant differences from IFRS

Exemption based on size
Micro-sized entities and small entities are exempt from preparing a cash flow statement under NL GAAP. IFRS does not provide exemptions based on the size of an entity for preparing a cash flow statement.

Gross or net cash flows
IAS 7 'Statement of Cash Flows' contains explicit provisions on circumstances in which cash flows may be presented on a net basis. Cash flows may be presented on a net basis if:

- receipts and expenditures on behalf of clients reflect the activities of the clients concerned rather than those of the entity itself; or
- the turnover of receipts and expenditures is high, amounts are large and maturities are short.

DAS 360 does not include such provisions.

Direct method
IAS 7 expresses a preference for the direct method in presenting cash flow from operating activities. It states that 'the direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method.' DAS 360 only indicates that a cash flow statement prepared using the direct method best reflects the actual cash flows. However, when the direct method is used, DAS 360 also recommends providing a reconciliation between operating profit or loss and cash flow from business activities. IAS 7 lacks such a provision.

Annex 1. Examples of cash flow statements

DAS 360 includes the following examples of a cash flow statement using the direct method and indirect method, respectively. Below, it has been decided that under the direct method, receipts from extraordinary income are not part of the cash flow from business activities because this subtotal consists of receipts and payments from normal operational activity. In the indirect method, receipts from extraordinary income are already included in the operating profit or loss.

Cash flow statement using the direct method (extracted from DAS 360)			
Receipts from customers	35,515		
Payments to suppliers and employees	(32,965)		
Cash flow from business activities		2,550	
Interest received	200		
Dividend received	190		
Interest paid	(270)		
Income tax paid	(900)		
Receipts on account of exceptional income	180		
		(600)	
Cash flow from operating activities			1,950
Acquisition of group entities		(300)	
Investment in tangible fixed assets		(350)	
Disposal of tangible fixed assets		20	
Cash flow from investing activities			(630)
Receipts from non-current debt		250	
Repayments of non-current debt		(90)	
Dividend paid		(1,200)	
Cash flow from financing activities			(1,040)
Net cash flow			280
Exchange rate and translation differences on cash			(10)
Increase in cash and cash equivalents			270

Cash flow statement using the indirect method (extracted from DAS 360)			
Operating profit or loss		3,470	
Adjustments for:			
Depreciation		450	
Movements in working capital:			
Increase in trade receivables	(500)		
Decrease in inventory	1,050		
Decrease in trade payables, including VAT to be paid/reclaimed	(1,740)		
		1,190	
Cash flow from business activities		2,730	
Interest received	200		
Dividend received	190		
Interest paid	(270)		
Income tax paid	(900)		
		(780)	
Cash flow from operating activities			1,950
Acquisition of group entities		(300)	
Investment in tangible fixed assets		(350)	
Disposal of tangible fixed assets		20	
Cash flow from investing activities			(630)
Receipts from non-current debt		250	
Repayments of non-current debt		(90)	
Dividend paid		(1,200)	
Cash flow from financing activities			(1,040)
Net cash flow			280
Exchange rate and translation differences on cash			(10)
Increase in cash and cash equivalents			270

26 Revenue recognition

26.1 Introduction

DAS 270 'The profit and loss account' and DAS 221 'Construction contracts' have been modified for financial years beginning on or after 1 January 2022. This chapter discusses the amended standards in DAS 270 'The profit and loss account'.

According to the Dutch Accounting Standards Board, the reason for the changes is the need in practice for further rules on how to recognise revenue under Title 9 Book 2 NCC and the Dutch Accounting Standards. When amending DAS 270 and DAS 221, the Dutch Accounting Standards Board carefully examined IFRS 15 'Revenue from Contracts with Customers' but deliberately chose not to adopt the provisions of IFRS 15 in full. The DASB did not consider it desirable to incorporate the provisions of IFRS 15 into the standards in full on account of the target audience of the standards combined with the associated costs of implementation. The Dutch Accounting Standards Board stresses that the provisions of IFRS 15 (including the further guidance on the application of IFRS 15 for the purposes of IFRS) are not leading in interpreting this standard.

The decision of the Dutch Accounting Standards Board not to incorporate IFRS 15 in full into the standards results in the transfer of risks and rewards still being the conceptual basis for recognising revenues. This differs from IFRS 15, where the transfer of control is the basis for revenue recognition. This is a significantly different conceptual basis and it may lead to differences in how specific rules are applied.

Application of IFRS 15 'Revenue from Contracts with Customers'
The pre-existing facility (option) in the standards to apply IFRS 15 'Revenue from Contracts with Customers' instead of DAS 270 and DAS 221 for the reporting of revenues and related expenses remains. This means that entities that want to stay as close as possible to the IFRS frameworks in their company-only financial statements under Title 9 Book 2 NCC (e.g. because IFRS must also be applied for consolidation purposes for the benefit of the ultimate parent entity) can continue to choose this option, but only if they apply IFRS 15 consistently and in full. If the entity uses this option, it will apply IFRS 15 instead of the provisions of DAS 270 concerning the sale of goods and the rendering of services and the provisions of DAS 221 on construction contracts (as described in Chapter 12).

The term revenue
Revenue is income generated from a company's normal, non-incidental business operations. A lot of terms are used to refer to revenue such as sales, fees, interest, dividends, royalties and rent (DAS 940). Solely amounts that a company receives for its own account (as principal) are classified as revenue (DAS 270.105a). Amounts it receives for third parties (as agents) are not recognised as revenue. The concept of net revenue and the principal-agent principle are discussed in more detail in paragraph 26.8.

Scope
This chapter deals with revenue recognition. It does not consider the recognition of revenue arising from or relating to:

- dividends from equity interests recognised using the net asset value method (Chapter 9);
- changes in the value of other current assets (Chapters 11 and 13);
- revenue from construction contracts(Chapter 12);
- changes in the fair value of financial assets and liabilities or their sale (Chapter 21);
- lease contracts(Chapter 22);
- insurance contracts and insurance companies;
- natural increase in livestock, agricultural or forestry products or the extraction of mineral ores.

Structure of this chapter
Revenue recognition consists of five steps which are discussed in the next five paragraphs. This five-step model is derived from IFRS 15. These steps are as follows:

1. identifying the contract (paragraph 26.2);
2. identifying the performance obligations in the contract (paragraph 26.3);
3. determining the transaction price (the amount of revenue) (paragraph 26.4);

4. allocating the transaction price to the performance obligations in the contract (paragraph 26.5);
5. recognising revenue (paragraph 26.6).

Paragraph 26.7 then discusses the recognition of sale transactions that include repurchase agreements; paragraph 26.8 deals with the concept of net revenue and paragraph 26.9 addresses the information to be included in the notes. Paragraph 26.10 examines the transitional provisions adopted by the Dutch Accounting Standards Board to simplify the implementation of the amended directives. Paragraph 26.12 summarises the main differences between the previous standards and the new, amended standards.

26.2 Identifying the contract

The provisions on revenue recognition are customarily applied to each individual contract (DAS 270.105). DAS 270 does not address the conditions a contract must meet to qualify for revenue recognition. Nor does it define the term 'contract'. This is logical, because every jurisdiction determines its own contract law. In Dutch contract law, the term 'contract' is defined as follows in Title 5 Book 6 NCC:

'A contract within the meaning of this title is a multi-sided legal act by which one or more parties enter into an obligation towards one or more other parties.' (Article 6:213(1) NCC).

According to IFRS 15, a contract with a customer must meet the following criteria:

1. the parties have approved the contract and committed themselves to their obligations;
2. the entity is able to identify each party’s rights in relation to the goods or services to be provided;
3. the entity is able to identify the payment terms for the goods or services to be provided;
4. the contract has commercial substance; and
5. it is probable that the entity will collect the consideration in exchange for the goods or services provided to the customer.

In our opinion, these criteria also provide guidance for accounting practices in the Netherlands. For example, revenue may not yet be recognised if goods or services have been provided without the customer being committed to provide any consideration. In Dutch law, we could then say that there is not yet a legal act whereby *both* parties (supplier and customer) have entered into an obligation.

Example: Identifying the contract (pushed sales)

At the end of September of year 1, a publisher distributes copies of the new annual edition (year 2) of a book to customers who ordered the previous annual edition (year 1). These customers do not have a subscription and are not required to purchase the year 2 edition. According to the enclosed invoice, if customers do not want the year 2 edition, they have until 1 December of year 1 to return it. Failure to return it means that payment is due by 31 December of year 1 according to the same invoice. The publisher operates in two countries: country A and country B. In country A, these *pushed sales* are allowed, meaning that failure to return by 1 December of year 1 will bind the customer. After this date, therefore, the customer is expected to provide consideration (payment). In country B, these *pushed sales* are not allowed and the customer has the right to return the edition even after 1 December year 1.

At the end of September of year 1, there is *no* contract in either situation because the customer has not entered into any obligation. They have in fact received an unasked for book. Let us assume that the customer does not return the book by 1 December of year 1.

In country A, it could be argued that on 1 December, there is an obligation on the customer to pay the invoice for the book given their failure to return it to the sender by 30 November of year 1. This failure to return is then seen as a legal act that gives rise to the obligation. Revenue will then in principle have to be recognised on 1 December because performance has been effected.

In country B, however, there is no reciprocal obligation, even after 1 December of year 1. Consequently, no revenue is recognised. We assume that, based on the above definition of a contract, the Netherlands is in the same category as country B. Whether revenue should be recognised is based on the specific facts and circumstances, in particular the communication between supplier and customer.

Let us now assume that the customer pays the invoice amount by bank transfer on 31 December of year 1. Does that then satisfy the condition of a contract having been concluded in country B?

In our opinion it does, as the payment makes it clear that the customer has accepted delivery of the book and has paid the consideration for it. The publisher can then recognise revenue in the fourth quarter of year 1.

Combining contracts
In certain cases, the revenue recognition provisions need to be applied to several contracts together to reflect their economic reality.

Revenue recognition criteria are applied to the totality of related contracts if they are so closely that they cannot be properly understood without considering them together. This could also be the case where there are multiple clients. For example, an entity may have entered into several separate contracts negotiated as a whole, where the individual contracts are closely related in terms of pricing and profit margin and they are performed simultaneously or immediately after each other (DAS 270.105).

Example: Combining sales transactions

When a machine is sold, a separate contract is entered into in which the supplier undertakes to buy back the machine back at a price agreed now. In such a situation, the economic reality may demonstrate that this is not a sale transaction but rather a type of lease. In that case, revenue from the sale of the machine is not recognised at the time of delivery. Instead, the difference between the selling price and the subsequent purchase price will be recognised as rental income over the term of the contract.

26.3 Identifying performance obligations in a contract

26.3.1 Performance obligations

Revenue recognition provisions should be applied to separately identifiable components of a contract in order to thus reflect the economic reality. DAS 270 includes specific provisions for identifying individual components. These are referred to as 'performance obligations'.

The principle of identifying distinct performance obligations is illustrated in the following example:

Example: 'Free' tablet with subscription (based on example 1a from Appendix 1 to DAS 270)

A publisher gives a new customer a 'free' tablet if they take out a three-year subscription to a magazine. The contract includes the following two promises to provide goods or services:

- the delivery of weekly magazines for the duration of the subscription; and
- the delivery of a tablet when the subscription begins.

The promises to deliver magazines over a three-year period and to deliver a tablet constitute distinct performance obligations. This is because the customer is able to benefit from both promises independently and these two promises are distinct in the contract. The total transaction price is allocated to these two performance obligations in proportion to their individual value. Revenue from the delivery of the tablet is recognised upon delivery of the tablet. Revenue from the delivery of the magazine is recognised over the three-year subscription period.

Revenue may not be allocated entirely to the delivery of the magazines (with the cost of the tablet being allocated to the subscription period).

A performance obligation is defined as a contractual promise to deliver (DAS 270.109):

- a distinct good or service or a combination of goods or services that are collectively distinct from other promises made in the contract; or
- a series of distinct services that are largely the same.

A performance obligation is a distinct obligation if the following criteria are met (DAS 270.109):

a. the customer can benefit from the goods or services either on its own or together with resources that the customer has or is able to obtain; and
b. the promise to transfer the goods or services is distinct from the other promises included in the contract.

Example: Software licence with other services; distinct performance obligations (based on example 1b from Appendix 1 to DAS 270)

A software developer enters into a contract with a customer agreeing to issue a software licence, carry out installation work and provide unspecified software updates as well as technical support (online and by telephone) for two years. This software licence, installation work and technical support are also sold separately. Installation work involves customising the screen for each type of user (e.g. marketing, inventory management and information technology). The installation work can also be carried out by other companies and does not significantly change the software. The software continues to function without the updates and technical support.

In this case, the contract contains the following four distinct performance obligations:

- the sale of the software due to the grant of a licence;
- installation work;
- provision of updates; and
- provision of technical support.

The delivered software continues to function without the updates and technical support. The customer can use the software and services independently (or together with resources they have or can obtain). In addition, the promises to provide the software and the services are distinct from each other in the contract. The various promises are therefore distinct performance obligations.

The total transaction price is allocated to the individual performance obligations in proportion to their value (see paragraph 26.5).

The sale of the software due to the grant of a licence creates a right to use the entity's intellectual property as it is when the licence is granted. This performance obligation is classified as the sale of an asset (see paragraph 26.6.1). Revenue from the delivery of the software is recognised upon its delivery (DAS 270.110).

The installation work is a service. Revenue from the installation work carried out is recognised in proportion to the services performed (DAS 270.115).

Updates and technical support are also services and revenue from them is recognised in the agreed two-year period in proportion to the services performed (DAS 270.115).

Example: Hosting of software; no distinct performance obligations (based on example 1c from Appendix 1 to DAS 270)

A software developer enters into a contract with a customer to provide a software licence for two years. The software developer combines this with hosting the software application. For technical reasons, the customer cannot use the software without the hosting provided by this particular software developer.

Consequently, the grant of the software licence is not a distinct performance obligation. The promise to provide the software licence and the commitment to host the software application together constitute one performance obligation. This performance obligation is classified as the rendering of services. The revenue from this performance obligation is recognised in the agreed two-year period in proportion to the services performed (DAS 270.115).

The following circumstances indicate that if a contract includes two or more promises of the entity to provide goods or services, those promises are not distinct (DAS 270.109):

- the entity provides a significant service of integration of the goods or services with other goods or services promised in the contract, where those goods or services collectively constitute the promise for which the customer has contracted. In other words, the entity uses the goods or services as a means to deliver the combined goods and/or combined services to the customer. One example of this is the construction of an office building by order of the customer;
- one or more of the goods or services significantly modify other goods or services promised in the contract. One example of this is a software installation by the entity that significantly modifies the software provided by that entity;
- the goods or services are highly dependent on, or closely related to, other goods or services promised in the contract. One example of this is operating software that forms an integral part of a machine supplied by the entity. Another is the development of a prototype by order of a customer. The design and production of the prototype are closely related.

Needless to say, some situations require considerable judgement to identify distinct performance obligations. This is illustrated in the following example:

Example: Installation of machine (based on example 3a from Appendix 1 to DAS 270)

If, in addition to the delivery of a machine, installation work is also done on it, then it is decided whether this delivery and installation are to be recognised as distinct performance obligations when the contract for that delivery and installation begins.

The supplier must then assess whether installation work will significantly affect the delivered machine. It must also assess whether this delivery and installation constitute a significant integration service. Also relevant is whether the machine and the installation work are highly interdependent or highly interrelated. If it considers that none of this is the case, then the delivery of the machine and the installation work are identified as distinct performance obligations. The revenue from the delivery of the machine is then recognised upon delivery (DAS 270.110). Revenue from the installation work is recognised while the installation work is being carried out (DAS 270.115).

If it is judged that the installation work significantly affects the delivered machine, there are no distinct performance obligations. In that case, just one single performance obligation is identified, namely the delivery of an installed machine. The revenue from this performance obligation is recognised upon installation of the delivered machine, because that is when the conditions set out in DAS 270.110 on the sale of goods are met.

If the contract with the entity includes two or more promises that are not distinct from each other, those promises should be combined for goods or services that are collectively distinct from the other promises made in the contract.

26.3.2 Warranties that constitute a distinct performance obligation

The standards describe when a warranty may be classified as a distinct performance obligation and when it may not.

A warranty is a distinct performance obligation if it (or part of it) entails the customer receiving a service in addition to the warranty that the product meets the agreed specifications. A regular warranty intended to assure the customer that a delivered good meets the agreed specifications does not qualify as a distinct performance obligation.

If a warranty provided in a transaction is a distinct performance obligation, part of the transaction price is allocated to this performance obligation and recognised as deferred revenue. If this is not the case, the expected warranty costs are recognised as a warranty provision. This provision is measured at the best estimate of future warranty costs (DAS 252.408).

Example: A warranty that does not constitute a distinct performance obligation (based on example 12a from Appendix 1 to DAS 270)

A washing machine manufacturer provides a two-year manufacturer's warranty when selling a new washing machine. This warranty is intended to provide the customer with assurance that the washing machine meets the agreed specifications. Therefore, this warranty is not treated as a distinct performance obligation.

The entity recognises the expected warranty costs as a provision. This is measured at the best estimate of the refundable warranty costs (see paragraph 16.7.3). The expected warranty costs (the entry of the warranty provision) are recognised as a separate cost item in the profit and loss account. The revenue from the sale of the washing machine is simultaneously recognised under revenue.

Example: Warranty that constitutes a distinct performance obligation (based on example 12b from Appendix 1 to DAS 270)

The washing machine manufacturer also offers the option of extending the warranty provided by it to five years after the delivery of the washing machine. This additional three-year warranty constitutes a distinct performance obligation.

The manufacturer allocates the transaction price to this performance obligation in proportion to the value of this additional warranty. The portion of the transaction price allocated to this performance obligation is not yet recognised as revenue when the washing machine is delivered. Instead, it is recognised as 'deferred revenue'. The additional warranty concerns the rendering of a service. The provisions on revenue recognition of services apply to this. This means that the portion of the transaction price allocated to the additional warranty is recognised separately as revenue in the years in which the services are provided (years three, four and five).

If a customer has the option to buy a warranty separately, this warranty is a distinct service. This is because the entity promises to provide a (warranty) service to the customer in addition to the delivered good. If the customer does not have the option to purchase a separate warranty, then the warranty is normally not treated as a distinct performance obligation. It is treated as one, however, if a warranty that cannot be bought separately provides a service in addition to assurance that the delivered good meets the agreed specifications. The entity must assess whether this is the case. The following and other factors could be relevant to this assessment (DAS 270.109b):

a. whether the warranty is required by law and merely protects against the risk of buying faulty goods;
b. the length of the warranty period; and
c. the nature of the tasks the entity promises to perform.

26.3.3 Customers' options on additional goods or services

Loyalty programmes providing loyalty points or bonus cards are examples of customer options on additional goods or services. Others include, for example, sales incentives, contract renewal options or other discounts on future goods or services.

If an entity grants a customer the option to obtain additional goods or services, that option only constitutes a distinct performance obligation if its value is not insignificant compared to the value of the sales for which it was granted. In such instances, the customer effectively pays in advance for these future goods or services. If this condition is met, a distinct performance obligation is recognised for the option granted. The revenue attributable to this option is then recognised in the period that the credits are redeemed (DAS 270.109a). The portion of the transaction price allocated to the option is then recognised on the balance sheet as 'deferred revenue' under 'prepayments'.

Example: Customers' options to obtain additional goods or services free or at a discount (based on example 11 from Appendix 1 to DAS 270)

A machine manufacturer enters into a contract with a new customer to buy a machine for 100,000. Under this contract, the manufacturer also grants the customer the future right to buy an identical machine outright at a 30% discount. This right only applies to one additional machine. Other customers can also negotiate such discount rates, but only when purchasing multiple machines. The machine manufacturer concludes that the value of the option it has granted is not insignificant compared to the value of the sold machine.

It recognises this future discount option for the customer as a distinct performance obligation (DAS 270.109a).

The machine manufacturer expects the probability of the customer exercising this option at 50%, and estimates its value at 15,000 (= 30% x 100,000 x 50%). The total transaction price (100,000) is allocated to the machine and the future discount option in proportion to the value of these two performance obligations:

Delivery of machine	87,000 (= 100/115 x 100,000)
Entitlement to one-off discount on new machine	13,000 (= 15/115 x 100,000)

Upon delivery of the machine, the machine manufacturer makes the following journal entry:

Bank	100,000	
Revenue		87,000
Deferred revenue		13,000

The revenue allocable to the discount option of 13,000 is recognised as an item of accruals and deferred income (deferred revenue). This amount is recognised as revenue in the profit and loss account when the machine is sold under the discount option granted. If no additional machine is sold under the discount option granted, the deferred revenue:

- is recognised as revenue if the option is no longer available (e.g. it has expired), or
- is recognised as revenue earlier if it is very unlikely that the discount option will be exercised.

If no distinct performance obligation is recognised when the option is granted, the revenue of the entire transaction is recognised at the time of the sale in which the option is granted. The costs of the options granted (i.e. the (estimated) amount of future goods and/or services or discounts) is in that case charged to the profit and loss account at the time of sale (DAS 270.109a). A liability for this is then recognised on the balance sheet.

26.4 Determining revenue (the transaction price)

The revenue from a transaction is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer (DAS 270.106). This is referred to as the transaction price; it excludes amounts collected (as an agent) on behalf of third parties (see paragraph 26.8).

The transaction price may be fixed or variable consideration or a combination of both. Credit risk is not taken into account when setting the transaction price. Any write-downs resulting from credit risk are recognised as costs in the profit and loss account. In determining the transaction price, the entity assumes that the goods or services will be provided in accordance with the relevant contract and that this contract will not be cancelled, extended or otherwise modified. The entity must measure any non-monetary consideration, for example consideration in kind, at fair value (i.e. market value).

In determining the transaction price, the entity takes into account, among other things, the effects of (DAS 270.106):

- variable consideration (paragraph 26.4.1);
- significant financing components (paragraph 26.4.2); and
- consideration payable to customers (paragraph 24.4.3).

26.4.1 Variable consideration

The transaction price may vary due to discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. It may also vary if the entity's right to the consideration is contingent on the occurrence of a future event. This is referred to as variable consideration.

Recognition of the amount of variable consideration is determined by an estimate that requires exercising prudence (DAS 270.106a). The aim of exercising prudence is to minimise the probability of subsequent reversals being required. The point at which variable consideration should be included in the transaction price (thus recognising revenue) is not exactly prescribed. Only the principle is described.

The entity updates its estimate of the amount of variable consideration at the end of each reporting period (DAS 270.106a).

According to the Dutch Accounting Standards Board, the uncertainty relating to variable consideration may be so high that it is not possible to reliably determine the total revenue and the profit or loss. One possible example of this is a contract where consideration is only payable if a certain profit is achieved ('no cure no pay'). If a contract provides for fixed and variable consideration, the amount of fixed consideration may be so high that it is possible to reliably determine the total contract revenue despite the uncertainty relating to the variable consideration (DAS 270.118).

Example: The total amount of revenue cannot be reliably determined (based on example 25a from Appendix 1 to DAS 270)

A law firm enters into a mediation agreement under which the consideration payable by the client depends on the personal injury compensation awarded ('no cure no pay'). The entire consideration is therefore variable. The law firm considers this estimate so uncertain that it cannot reliably determine the amount of total revenue, meaning that this criterion for revenue recognition is not met (DAS 270.115(a)).

The law firm only recognises revenue in the amount of the costs incurred for services rendered that can probably be recovered (DAS 270.121).

Example: The total amount of revenue can be reliably determined (based on example 25b from Appendix 1 to DAS 270)

A consultancy firm enters into a contract with a client under which it prepares a report recommending energy-saving measures. The contract includes both fixed and variable consideration. The fixed consideration of 105 results in a small margin of 5% compared to the budgeted cost of 100. In addition a variable consideration can be realised. The amount of it depends on a number of variable performance criteria related to the energy savings to be achieved by the client. The probability of variable consideration being zero is estimated at 40%. It is also estimated that the probability of it being 10 is 30%, and the probability of it being 20 is estimated at 30%. For reasons including prudence, the consultancy firm estimates the variable consideration at zero for the time being.

Given the amount of fixed consideration compared to the transaction price, the consultancy firm concludes that the total revenue from the project can be reliably determined. Thus, the criterion that the revenue can be reliably determined has been met (DAS 270.115(a)). The consultancy firm recognises revenue in proportion to the services performed based on the fixed consideration.

26.4.2 Significant financing component

It can happen that the receipt of consideration for the delivery of a good or service is deferred without an interest payment having been agreed. Another possibility is that the entity has received pre-financing from a customer. In both situations, the transaction price is adjusted for the effects of the time value of money if a contract includes a significant financing component. A contract may include a significant financing component if the construction contract is completed earlier or later than payment of the consideration. If it does include a significant financing component, the time value of money is recognised separately as interest in the profit and loss account (income or expense).

Consequently, this applies to both financing provided and financing received. As for the delivered goods or services themselves, revenue is recognised at the time of delivery based on the selling price excluding the interest surcharge. This selling price is the present value of the total consideration paid (either in advance or in arrears, possibly in instalments).

Whether a financing component is significant depends on its relative size. In any case, a financing component may be considered insignificant if, at contract inception, the entity expects the financing period (i.e. the period between delivery and payment) to be no more than one year.

An interest rate must be applied to calculate the present value. The interest rate must be set at (DAS 270.107b):

- the prevailing rate for a similar instrument of an issuer with a similar credit rating; or
- the interest rate that discounts the transaction price to the current cash selling price of the goods or services.

The difference between face value and fair value is recognised as interest revenue or an interest expense in the customary manner in the period between the date of delivery of the good or service and the expected receipt (i.e. by amortisation using the effective interest method).

Example: Significant financing component (1)

A company sells goods for 20,000. Although the customary payment period is one month, 13 months is agreed with this particular customer. The generally applicable interest rate for a similar financing instrument of a company with a similar credit rating is 4%.

When this transaction is concluded, the seller recognises revenue of 19,230, being the present value of 20,000 calculated using a discount rate of 4% over 12 months. The difference between the two amounts, i.e. 770, is interest. The receivable is initially measured at fair value of 19,230, in accordance with DAS 290 'Financial instruments'. It is periodically increased by the interest revenue over this period, i.e. 770, until the company receives the 20,000. After 13 months, the carrying amount of the receivable is 20,000.

Example: Significant financing component (2)

A company sells goods for 20,573 and agrees a payment period of 13 months, although its customary payment period is one month. If the customer did in fact pay within one month, the selling price would have been 19,500. The selling price therefore includes 1,073 interest. This corresponds to an interest rate of 5.5%.

When this transaction is concluded, the seller recognises revenue of 19,500, being the price a customer would have to pay if it paid within the customary period. The receivable is initially measured at fair value of 19,500, in accordance with DAS 290 'Financial instruments'. The difference between fair value and the agreed selling price is recognised as interest over the payment period. The receivable is periodically increased by the interest revenue over this period, i.e. 1,073, until the company receives the 20,573. After 13 months, the carrying amount of the receivable is 20,573.

Example: Significant financing component (3) (based on example 29 from IFRS 15)

Company A enters into a contract with a customer for the sale of an existing building. The building is to be handed over to the customer in two years. The contract includes the choice between two payment options: payment of 5,000,000 in two years when the customer acquires the asset, or payment of 4,000,000 when signing the contract. The customer opts to pay 4,000,000 on signing the contract.

The contract includes a significant financing component due to (1) the period that elapses between the customer paying for the building and when A hands it over to the customer, and (2) the current market interest rates.

The interest rate implicit in this transaction is 11.8%, which is the rate that would make the two alternative payment options economically equivalent. However, the generally applicable interest rate for a similar financing instrument from an issuer with a similar credit rating is 6%. Since this is the rate that would apply under a separate financing agreement, A determines that it is the rate it will use to adjust the transaction price.

On receiving payment from the customer, A recognises the received amount of 4,000,000 under 'prepayments' (as part of debt). This item is increased by interest during the payment period. For the first year, A recognises an interest expense of 240,000 (= 4,000,000 x 6%) and for the second year 254,400 (= 4,240,000 x 6%). The 'prepayments' item is then 4,494,400 (= 4,000,000 + 240,000 + 254,400) at the end of the second year. When the building is handed over, A recognises this amount as revenue.

Under IFRS, the assessment of whether there is a financing component is not based solely on the time value of money. The reason for a prepayment or deferred payment is also taken into account. Under IFRS, for example, no financing component is recognised if there is a time value (i.e. the difference between the transaction price and the cash selling price of the good or service) for reasons other than the provision of finance to either the customer or the entity, and the time value is proportional to the reason for the difference. For example, if the prepayment or deferred payment is made to protect the entity or customer from the other party failing to adequately complete some or all of its obligations under the contract (IFRS 15.62). We certainly consider such an economic reality-based assessment of whether or not a contract includes a significant financing component to be applicable under DAS 270.

26.4.3 Consideration payable to customers

Sometimes a supplier makes payments to a customer, for example to compensate the customer for investments it needs to make to sell the supplier's products. A supplier might also pay a fee to a customer in exchange for it displaying the supplier's products conspicuously.

Consideration payable to a customer is deducted from revenue unless it is in exchange for a distinct good or service (DAS 270.108). The recognition of consideration payable to customers therefore depends on whether or not it is in exchange for a distinct good or service. If consideration payable to a customer is a payment for a distinct good or service from the customer, then the supplier recognises it as the purchase cost of that good or service.

Example: Consideration payable to customer (based on example 32 from IFRS 15)

Company A produces bakery products. A enters into a contract under which it sells bakery products to a large supermarket chain. The supermarket chain undertakes to buy products worth at least 15 million over the next three years (i.e. at least 5 million annually). The contract also obliges A to make a non-refundable payment of 1.5 million to the supermarket chain at the start of the contract. This payment of 1.5 million compensates the supermarket chain for the adjustments it has to make to its shelves to accommodate A's products.

A concludes that this payment is not in exchange for a distinct good or service that the supermarket chain transfers to A. This is because A makes the payment solely because of its supplies of goods to the supermarket chain. A does not acquire any rights to the supermarket chain's shelves. A therefore concludes that the payment of 1.5 million is a reduction of the transaction price.

A recognises a prepayments and accrued income item of 1.5 million at the time of payment. It then recognises the consideration payable as a reduction in the transaction price at the point that it recognises revenue from the transfer of the goods. As it transfers goods to the supermarket chain, A reduces the transaction price for each good by 10 per cent (1.5 million / 15 million). In the first year, A therefore recognises revenue of 4.5 million (the invoiced amount of 5 million less the portion of the consideration payable to the supermarket chain that is allocated to that, i.e. 0.5 million).

26.5 Allocating the transaction price to performance obligations

Once the performance obligations under a contract have been identified and the (total) transaction price has been determined, the transaction price is allocated to those performance obligations. The transaction price is allocated in proportion to the value of the performance obligations (DAS 270.109c). This step is obviously only applicable if multiple performance obligations are identified in a contract. The question is then to determine the value of these individual performance obligations that serves as the basis for this allocation.

The standards provide two options (DAS 270.109c):

- base the allocation on the stand-alone selling price for each individual performance obligation. The stand-alone selling price is the price the entity would charge if the goods or services were sold separately. If the stand-alone selling price is not known, the entity uses estimates; or
- alternatively, the entity bases this allocation on the fair value of the performance obligations (i.e. market value) instead of the stand-alone selling price.

Example: Consideration for the development of custom software (based on example 23 from Appendix 1 to DAS 270)

An entity enters into a contract for the development of custom software and post-delivery support for a total consideration of 100. Let us assume that this development and post-delivery support of the custom software are distinct performance obligations. The transaction price is allocated to both performance obligations in proportion to their value (DAS 270.109c). The stand-alone selling price of the development of custom software is 90. The stand-alone selling price of the support is 30.

Consideration of 75 (= 100 * 90 / (90 + 30)) is allocated to the development of the custom software. Consideration of 25 (= 100 * 30 / (90 + 30)) is allocated to support.

The development of custom software involves the rendering of services, and consideration for this is, in principle, recognised as revenue in proportion to the services performed (DAS 270.115), i.e. according to the progress of the work. In the situation where the proper functioning of the custom software is essential for its acceptance by the client - and thus for payment for its development - and such acceptance is by no means certain, revenue cannot be recognised until after it has become likely that the client will accept the software and its development.

Post-delivery support for the custom software is a service rendered. The portion of the transaction price allocated to this services is recognised in proportion to the support provided (DAS 270.115).

Given the wording: 'alternatively, the entity bases this allocation on the fair value instead of the stand-alone selling price', the standards exclude any other alternatives. For example, allocation based on the relative stand-alone gross margins of the individual performance obligations (a variant of allocation based on stand-alone selling prices) does not seem to be allowed.

26.6 Revenue recognition

This paragraph addresses the criteria for revenue recognition in the following situations, in the order shown:

- sale of goods (paragraph 26.6.1);
- providing services (paragraph 26.6.2);
- licensing (paragraph 26.6.3);
- non-refundable upfront fees (paragraph 26.6.4);
- customers' unexercised rights (paragraph 26.6.5);
- contract modifications (paragraph 26.6.6);
- interest, royalties and dividends (paragraph 26.6.7).

26.6.1 Sale of goods

Revenue from the sale of goods is only recognised if all the following conditions are cumulatively met (DAS 270.110):

- the company has transferred all significant rights to economic benefits as well as all significant risks relating to the goods to the purchasing party;
- the company does not retain any ongoing involvement in the goods sold, as the owner does, such that it continues to have effective control over them and thus the power to decide on their use;
- the amount of revenue can be reliably determined;
- it is probable that the future economic benefits associated with the performance obligation will flow to the company; and

- the costs already incurred and potentially to be incurred in relation to the performance obligation can be reliably determined.

Transfer of significant rights to economic benefits and risks
The most significant rights to economic benefits or risks are not transferred if the customer has the right to return the goods based on the sale contract and the company cannot reliably estimate the extent of returns. Another example where rights and risks are not transferred is where goods are supplied for an installation which the supplier will also carry but has not yet completed it and where that installation constitutes a material element of the contract. In this situation, therefore, the delivery of those goods may not be recognised as realised revenue. Nor are all significant risks transferred where the revenue from a sale is contingent on the revenue that the customer itself is able to generate from its sale of goods. In this situation, revenue may not yet be recognised either (DAS 270.111).

Revenue may, however, be recognised if only insignificant rights to economic benefits or insignificant risks remain with the seller, (DAS 270.112). This is the case, for example, if the supplier retains legal title solely in order to reduce the risk of bad debt.

Example: Retention of legal title

A manufacturing company drafts its sales contracts in a way that ensures that legal title is transferred upon payment of the goods and not upon their delivery. Goods are sold and delivered to a customer that does not usually pose a credit risk.

Significant rights to economic benefits as well as all significant risks have passed to the customer, despite the customer not yet having legal title to the goods. The passing of legal title is merely an indicator that the significant rights to economic benefits as well as all significant risks have passed to the customer. Therefore, assuming all other conditions set out in DAS 270.110 are met, revenue should be recognised, given that the only right that the manufacturing company still has is the right to recover the goods if the customer fails to make payment.

Returns
Under some contracts, a customer has the right to return goods sold to them for reasons of dissatisfaction. In that case, the entity recognises revenue for the goods sold and delivered if it can reliably determine the extent of any returns. Upon delivery of the goods, it does not recognise revenue for any amount of consideration it does not expected to be entitled to. The entity recognises such amounts as a refund liability (DAS 270.112).

The provisions on variable consideration are relevant in determining the consideration to which the entity expects to be entitled (see paragraph 26.4.1).

The entity recognises an asset for its right to recover goods from the customer on settling the refund liability. This asset is initially measured by reference to the former carrying amount of the good (e.g. the inventory sold), less any expected cost of recovering those goods and any possible impairments of them. The refund liability is measured at an estimate of the entity's obligation to refund the purchase amount. The entity exercises prudence in this regard, the aim being to ensure that it only recognises revenues that are unlikely to have to be reversed later, i.e. in accordance with the principles for the recognition of variable consideration described in paragraph 26.4.1. At the end of each reporting period, the entity updates its measurement of the asset and refund liability in line with of any changes in expectations about goods to be returned.

Example: Returns (based on example 3e from Appendix 1 to DAS 270)

In one month, company A sells 1,000 products to various customers at 100 each. The total consideration is therefore 100,000. Customers owe payment in advance, but have the right to return unused goods within 30 days. They will then be refunded the full purchase price. A's cost for each product is 60.

Based on the expected value method, A expects that 5% of its deliveries will be returned legitimately (50 products). A also expects the restoration costs of the returns to be negligible, and that it will be able to resell any returns with a profit margin. Taking delivery of any returns is not expected to result in material costs.

In this situation, A recognises 95,000 in revenue upon delivery of 1,000 products, as it expects 5% of the products to be returned. This means that not all significant rights to economic benefits or all significant risks have yet been transferred to the customer for this portion of the goods. The estimated refund liability (5,000) is deducted from the consideration.

The journal entry reads:

Bank	100,000 (= 1,000 products x 100)	
Revenue		95,000 (= 950 products x 100)
Refund liability		5,000 (= 50 products x 100)

This refund liability represents the estimate of the entity's obligation to refund the purchase price if the customer exercises their right of return. This estimate is made with prudence, thus minimising the probability of some of the recognised revenue of 95,000 having to be reversed later. This refund liability can be presented as an accrual under current liabilities.

Cost accounting is as follows:

Cost of revenue	57,000 (= 950 products x 60)	
Right to receive returns	3,000 (= 50 products x 60)	
Inventory		60,000 (= 1,000 products x 60)

The right to receive returns is linked to the satisfaction of A's obligation to receive returns and refund the purchase price. A has the right to take the unused goods and resell them. This right therefore represents a value presented separately from the refund liability. The right to receive returns is in the nature of a non-financial receivable that can be presented as a prepayment and accrued income item under current assets.

Material costs for accepting returns

If the entity expects to incur material costs for taking back the goods, then it deducts these costs from the asset item 'right to receive returns'. The fact is that these goods have a lower value for the entity. If the expected cost is 500, the cost accounting is as follows:

Cost of revenue	57,500 (= (950 products x 60) + 500)	
Right to receive returns	2,500 (= (50 products x 60) – 500)	
Inventory		60,000 (= 1,000 products x 60)

Let us assume that 4% (40 products) instead of 5% (50 products) are ultimately returned. The cost of taking them back is 500, in line with expectations. This results in an adjustment of 1,000 to the revenue recognised (= 10 products x 100). The return is recognised as follows:

Refund liability	5,000 (= 50 products x 100)	
Bank		4,000 (= 40 products x 100)
Revenue		1,000 (= 10 products x 100)
Inventory	1,900 (= (40 products x 60) – 500)	
Cost of revenue	600 (= 10 products x 60)	
Right to receive returns		2,500 (= (50 products x 60) - 500)

Likelihood of economic benefits
The factual situation is relevant to determining the likelihood that economic benefits relating to the transaction will flow to the entity. Sometimes economic benefits are not likely until a particular uncertainty has been removed. For example, payment of the sale amount may be subject to approval by a third party (e.g. a foreign government agency). In an uncertain situation like this, revenue should not be recognised until approval is granted. It may, however, be recognised if that approval is actually a formality and will probably be granted.

An estimate of the amount of variable consideration may also be so uncertain that the amount of total revenue cannot be reliably determined. See paragraph 26.4.1. The purpose of not recognising revenue in a situation where it cannot be reliably estimated is to ensure that only revenue that is unlikely to have to be reversed later is recognised.

A specific situation arises where there is uncertainty about the collectability of a receivable where the revenue relating to it has already (correctly) been recognised in the profit and loss account. In such cases, the amount that is uncertain (i.e. the write-down of the receivable due to credit risk) is recognised as a cost in the profit and loss account. Therefore, this amount may not be classified as a reduction of previously recognised revenue (DAS 270.113). Credit risk is not taken into account when setting the transaction price. Any write-downs resulting from credit risk are recognised as costs in the profit and loss account (DAS 270.106).

Costs already incurred and potential costs in relation to the transaction can be reliably determined
The idea behind this condition of revenue recognition is that the costs and revenues relating to the same performance obligation are recognised in the profit and loss account in the same period. As a result, if the costs cannot yet be reliably determined, then revenue may not be assumed either, and it is recognised as deferred revenue in accruals and deferred income (DAS 270.114). One example of this is the non-recognition of revenue from a sale if the associated after-sales costs, including warranty costs etc, cannot be reliably determined and carry more than limited risk in view of their potential size. This generally only applies in exceptional situations given that, partly based on experience, it is usually possible to estimate the warranty costs.

Example: Warranty

A company makes custom machine parts and gives a specific three-month warranty on them in addition to the normal two-year warranty. This warranty covers the costs of adjustments or repair after delivery. It is plausible to assume that the machine parts will have some serious problems that need to be repaired after they have been delivered. These involve adapting the parts to the customer's own particular environment. The costs of these adjustments and repairs cannot be reliably estimated. According to the contractual terms of sale, ownership passes on delivery.

Significant rights to economic benefits as well as all significant risks are only transferred after the three-month warranty expires. Adjustments after delivery are expected to be material. The company retains a liability in the event of unsatisfactory performance, which is not covered by the normal warranty provisions (DAS 270.111). This means that significant rights to economic benefits as well as all significant risks have not yet been transferred. In addition, the costs of adjustments and repairs cannot be reliably estimated. On this basis, revenue is only recognised after the three-month warranty expires. In this particular case, the significant rights to economic benefits as well as all significant risks have still not been transferred even if the costs of adjustment and repair can in fact be reliably estimated for this three-month period. A provision needs to be recognised for the normal two-year warranty obligation.

Consignment sales where the customer sells items on behalf of the supplier
If a customer (purchaser) makes consignment sales of items on behalf of the supplier (seller), revenue from them is only realised when the customer has actually sold them to a third party. The supplier only recognises revenue at that point.

Cash on delivery shipments
Revenue from cash on delivery shipments is not recognised until the goods have been delivered and the seller or its agent has been paid for them.

Sales to intermediaries for resale purposes
Similarly, in the case of sales to intermediaries (e.g. distributors or dealers) for resale purposes, revenue is not recognised until all significant rights to economic benefits as well as all significant risks relating to the goods have been transferred to the customer.

Example: Unlimited right of return

Publisher A BV sells books to intermediaries. A's main customers are distribution houses. However, it also sells to other customers such as small shops. Sale contracts with major distribution houses enable these houses to return slow-selling items to A. However, the sale contract does not define what is meant by slow-selling items. Returns may result in inventory being replaced in exchange for new books, or a cash refund. According to the sale contract for other customers, returns may not exceed 10% of the total quantity purchased. In both cases, A can reliably estimate the volume of returns based on past experience. How should A recognise revenue from sales to the distribution houses (which have an unlimited right of return) and to the other customers (which have a limited right of return)?

An important condition for recognising revenue from the sale of goods is that the company has transferred all significant rights to economic benefits as well as all significant risks relating to the goods to the customer (DAS 270.110). In both cases, the customer has acquired all significant rights to economic benefits as they have an unlimited right to resell the goods. Furthermore, expected returns from both types of customers can be reliably determined, thus enabling A to determine the degree of transfer of economic benefits as well as the significant risks. All significant risks have been transferred, because A is able to reliably estimate expected returns. A therefore recognises revenue on delivery of the goods, taking into account the expected amount from expected returns. See the calculation of this below.

The situation would be different if A was not able to reliably estimate expected returns. A would then run an undeterminable risk as regards saleability and obsolescence. In that case, the conditions of DAS 270.110 are not met and A recognises revenue on a consignment basis (i.e. when its customers resell goods).

This is illustrated by the following example. In December, A sells 10,000 books to a distribution house for 15 per book. The cost of one book is 10. Based on past experience, A expects 10% of the books sold to be returned in the ensuing financial year for cash payment. It also knows that it will be able to sell these returns at or above cost to an outlet.

It makes the following entry for the December sale:

Accounts receivable	150,000	
Revenue		135,000
Refund liability		15,000
Cost	90,000	
Right to receive returns	10,000	
Inventory		100,000

As regards returns (ensuing financial year):

Refund liability	15,000	
Bank		15,000
Inventory	10,000	
Right to receive returns		10,000

A also creates an obsolescence provision if it expects to sell returns to outlets below cost.

26.6.2 Rendering of services

Recognition of revenue from services rendered depends on whether the profit or loss of a transaction can be reliably estimated. If it can, revenue is recognised in proportion to the services performed. The profit or loss can be reliably estimated if all the following conditions are met (DAS 270.115):

1. the amount of revenue can be reliably determined;
2. it is probable that the future economic benefits associated with the performance obligation will flow to the entity;
3. the extent of the service rendered can be reliably determined at the reporting date; and
4. costs already incurred and potential costs to complete the service can be reliably determined.

If the final outcome of a contract cannot be reliably determined but is expected to yield a profit, revenue should only be recognised in the amount of the service costs incurred that can probably be recovered (DAS 270.121). However, if the final profit or loss cannot be reliably determined and, moreover, it is expected that the costs incurred up to that point cannot be made up by the contract revenue, then no revenue is recognised (DAS 270.122). However, costs already incurred are then recognised in the profit and loss account.

The amount of revenue can be reliably determined
The amount of revenue tends to depend on several factors. In general, the amount of revenue can be reliably estimated if the parties have agreed the mutual rights and obligations, consideration for the services rendered, the method of paying consideration and the terms of payment.

Example: Revenue-dependent bonus

Company A BV is an investment entity. A BV receives a bonus of 1 million when one of the funds managed by A BV earns a return that exceeds the AEX by more than 20% in the current calendar year. A BV's financial year ends on 30 June of that year. At that reporting date, i.e. halfway through the calendar year, the return of the managed fund exceeds the AEX by 25%. Should A BV include the bonus in its half-year figures as at 30 June?

According to DAS 270.110d, revenue is only recognised when it can be reliably determined and it is probable that the economic benefits will flow to the company. Company A does not receive the bonus until it is determined that the return on the fund exceeds the AEX by 20% over the entire calendar year. Since securities markets are volatile, the AEX's return cannot be reliably estimated over the next six months. Consequently, the bonus cannot be reliably determined before the end of the calendar year. The conclusion is that A BV should not recognise bonus revenue at 30 June. This is in line with the provisions on variable consideration (see paragraph 26.4.1).

Likelihood of economic benefits
Also for the recognition of revenue from services provided, if at any time uncertainty about the collectibility of the receivable arises, any expense incurred in relation to this must be recognised separately and therefore cannot be deducted from the revenue previously recognised (DAS 270.117).

Extent of performance can be reliably determined
Depending on the nature of the service, the determination of the extent of performance may be made on the basis of (DAS 270.119):

- an assessment of the work carried out;
- services rendered up to that point as a percentage of the total rendering of services;
- the costs incurred for services up to that point as a percentage of the estimated costs for the total rendering of services.

This means that already invoiced instalments and advance payments are generally not representative of the extent to which services have been provided.

Example: Extent of performance

A contract is agreed in October to render services for a number of hours. The calculation reads 1,000 hours x 100 per hour = 100,000. The contract also includes arrangements for invoicing in instalments.

Month	Hours worked	Sale amount	Invoiced	Balance invoiced in advance
November	200	20,000	40,000	20,000
December	400	40,000	30,000	10,000
Subtotal	600	60,000	70,000	10,000
January	300	30,000	25,000	(5,000)
February	100	10,000	5,000	(5,000)
Total	1,000	100,000	100,000	0

Revenue of 60,000 is recognised at 31 December. The invoiced 'excess' of 10,000 is recognised on the balance sheet as a pre-invoiced amount under current liabilities.

Example: Fee for lifetime membership of a private club

Company A BV operates and owns a private golf club. New members have the option of paying the total membership fee in advance instead of making annual payments. This one-time fee entitles members to most, but not all, of the club's services for life and it is non-refundable. Lifetime members must pay separately for services not covered by lifetime membership. How must A recognise revenue from lifetime membership?

It allocates revenue over the time the member is expected to use the golf club's services. According to DAS 270.115, revenue relating to a service is recognised in proportion to the services performed. A member will not pay an advance membership fee prior if they do not expect to use the golf club's services. In addition, lifetime membership and monthly fees are closely related.

Costs already incurred and potential costs to complete the service can be reliably determined.
This condition should be applied by analogy to what is included in the sale of goods. If the selling price of a product includes an identifiable amount for service work (e.g. for providing instructional sessions for software sold), revenue is recognised as income in the period in which that work is carried out. The amount of as yet unrecognised income equals the expected costs to be incurred for the relevant work plus a reasonable profit markup.

Agent's fees
An agent recognises received or receivable fees, for which it does not need to render any further services, as revenue when concluding or renewing its contract. However, if it is likely that the agent will still need to perform certain work during the term of the contract, the agent does not yet recognise its entire fee as revenue but rather allocates it to the period that coincides with the term of the contract. This depends in particular on exactly what performance obligation(s) the agent has yet to satisfy under the contract (see paragraph 26.3.1).

Consideration for development of custom software
Consideration for the development of custom software is recognised as revenue by reference to the stage of completion of the work. This also takes into account the support required after the software is delivered.

Example: Consideration for the development of custom software (based on example 23 from Appendix 1 to DAS 270)

An entity enters into a contract for the development of custom software as well as for post-delivery support. It establishes that the development of the custom software and post-delivery support are distinct performance obligations (in line with DAS 270.109). The transaction price is allocated to both performance obligations in proportion to their value (in accordance with DAS 270.109c).

In principle, consideration for the development of custom software is recognised as revenue by reference to the stage of completion of the work. In the situation where the proper functioning of the custom software is essential for its acceptance by the client - and thus for payment for its development - and such acceptance is by no means certain, revenue cannot be recognised until after it has become likely that the client will accept the software and its development.

The portion of the transaction price allocated to post-delivery support of the custom software is recognised in accordance with DAS 270.115 on the rendering of services.

26.6.3 Licensing revenue

A licence establishes a customer's rights to the entity's intellectual property. Licences can include software, films, music and other forms of media and entertainment, franchises, patents, trademarks, brands and copyrights (DAS 270.123).

To recognise revenue from a licence where it is a distinct performance obligation, it is necessary to determine its nature, i.e. whether it is (1) the sale of a good or (2) the rendering of a service. The entity considers whether the licence is by nature (DAS 270.125):

- the grant of a right to use the entity's intellectual property as it exists at the time the licence is granted. This means that the entity has no significant obligation to maintain or improve its intellectual property. Revenue from the licence is then recognised as the sale of a good (in accordance with DAS 270.110, see paragraph 26.6.1); or
- the grant of a right to access the entity's intellectual property as it exists for the entire duration of the licence. This means that the entity has a significant obligation to maintain or improve its intellectual property. Revenue from the licence is then recognised as the rendering of a service (in accordance with DAS 270.115, see paragraph 26.6.2).

Example: Revenue from licences (based on example 24e from Appendix 1 to DAS 270)

Company A grants a licence to a customer entitling it to use software developed by A for a period of three years. The customer's annual payment for this licence is 100. A develops the software continuously because it is used in an environment where technology plays an important role. During the term of the contract, the customer receives periodic software updates, ensuring that they always have the latest version of the software.

A recognises this licence as the rendering of a service. It therefore recognises revenue over the period of service in proportion to the services performed. In principle, this is 100 every year. This is because the licence entails a right to access the entity's intellectual property as it exists throughout the duration of the licence.

If A were to grant a licence for the software as it existed at the time the licence was granted without having any significant obligation to maintain or improve the software, its performance obligation would be classified as the sale of an asset. In that case, it would recognise the revenue from the licence on delivery of the software.

If the promise to grant a licence is not a distinct performance obligation, this promise and other goods or services promised are recognised as a single performance obligation (DAS 270.124). The recognition of revenue then depends on whether that performance obligation is classified as the provision of a good or a service. If it is classified as a good, revenue is recognised on delivery of the good (DAS 270.110). If classified as a service, revenue is recognised in proportion to the services performed (DAS 270.115).

Example: Licensing revenue (based on example 56 from IFRS 15)

A pharmaceutical company grants a customer a 10-year licence to use its patent rights to an approved drug and also agrees to produce the drug for the customer. The drug is a mature product, meaning that the pharmaceutical company will not provide any further support for it. Given the highly specialised nature of the manufacturing process, no other supplier is able to produce this drug. Consequently, the licence cannot be bought separately from the manufacturing service required to produce the drug, meaning that the customer needs this manufacturing service to benefit from the licence. Therefore, the licence and the manufacturing service are not distinct from each other and the pharmaceutical company recognises the licence and the manufacturing service as a single performance obligation. The pharmaceutical company must, however, determine whether this performance obligation entails the provision of a good or a service. If it is the provision of a good, the company recognises revenue on delivery of the drugs to the customer. If it is the provision of a service, the company recognises revenue in proportion to the services provided over the 10-year licence period.

26.6.4 Non-refundable consideration on conclusion of a contract

In some cases, the entity charges the customer non-refundable consideration when entering into a contract. Examples include registration fees to join a fitness club, activation fees in telecommunication contracts and start-up fees in certain service contracts.

Non-refundable consideration is usually charged for an activity that the entity needs to undertake at or around the start of a contract in order to perform it. However, this does not always directly result in the provision of a good or service to the customer. In such situations, the consideration is an advance payment for the provision of expected future goods or services. The entity only recognises revenue on delivery of those expected future goods or services (DAS 270.127).

Example: Consideration for registration and admission of a member and membership fees (based on example 21 from Appendix 1 to DAS 270)

A fitness club charges a registration and admission fee to anyone wishing to become a member. Non-refundable consideration for registration and admission as member of a fitness club is not recognised as revenue at once. Although non-refundable consideration may relate (in part) to an activity that the fitness club is required to undertake at or around the start of the contract in order to perform it, that activity does not generally entail the entity delivering any promised good or service to the customer. In such situations, the fee for membership registration and admission is recognised over the period that the fitness club expects to satisfy its performance obligation to make the fitness facilities available (DAS 270.127).

If, however, joining a fitness club involves a comprehensive intake that includes drawing up a fitness programme, that constitutes a distinct performance obligation in addition to the performance obligation to actually provide the fitness facilities. In that case, the transaction price is allocated in proportion to this performance obligation and recognised as revenue at the point of the intake and drawing up of the fitness programme (DAS 270.109c).

26.6.5 Rights not exercised by customers

In certain sectors, customers pay non-refundable consideration to an entity entitling them to receive goods and services in the future. Examples include advance payments for theatre performances and ferry or tunnel tickets. However, customers do not always exercise the rights granted to them.

Rights not exercised by customers do not create any financial obligation (e.g. a refund). They do, however, create an obligation to provide goods and/or services. The question is then how to measure this obligation and when (and to what extent) the entity should recognise revenue while simultaneously writing down its liability. The standards distinguish two situations (DAS 270.128):

1. the entity does not expect customers to exercise all the rights granted. In this situation, the amount relating to these rights is recognised as revenue in line with the pattern of rights that the entity expects the customer to exercise;
2. the entity does expect customers to exercise all the rights granted. In this situation, the amount relating to unexercised rights is not recognised as revenue until it becomes highly unlikely that the customer will exercise its remaining rights.

Example: Tickets at a theatre (customers do not exercise all the rights granted) (based on example 13b from Appendix 1 to DAS 270)

A theatre sells 190 tickets to a show for 50 per ticket. Tickets cannot be cancelled. Customers pay for their tickets in advance. Based on historical data, the theatre expects that only 180 customers will actually attend the show.

The theatre recognises prepayments from all customers (including those not expected to attend) as an accrual (deferred income) until the performance actually takes place and the service has been performed (DAS 270.128). Despite the fact that the theatre expects 10 customers not to attend the performance, it does not process the related income until the service has been performed. The fact is that it is only when it performs the service that it meets the requirements of DAS 270.115 on the rendering of services. Revenue from unused tickets is therefore recognised in accordance with the pattern of rights that customers do exercise.

Example: Strip tickets to a gym (customers do not exercise all the rights granted) (based on example 13a from Appendix 1 to DAS 270)

A gym issues strip tickets to customers. One strip ticket costs 70 and contains ten strips. The tickets remains valid until all 10 strips have been used. The gym sells 100 strip tickets at the beginning of the year. From experience, the gym can reliably estimate that customers use an average of 80% of these strip tickets spread over the first six months. It does not expect customers to use the remaining 20%.

Based on this information, the gym recognises 20% of the prepayment received (1,400 (= 20% of (100 x 70))) as revenue during the first six months. This is in line with the recognition of revenue from utilised strip tickets for the first six months amounting to 5,600 (= 80% of (100 x 70)). Revenue from unused strip tickets is therefore recognised in line with the pattern of rights that the gym expects its customers to exercise (DAS 270.128).

On the other hand, if the gym expects customers to use all the strips, then it only recognises revenue for any unused strips at the point when it becomes highly unlikely that customers will use their remaining strips. For example, if on the basis of historical data customers are highly unlikely to use their strip ticket again after a gap of 12 months, the gym then recognises the amount relating to these unexercised rights (the remaining balance on the strip ticket) as revenue.

26.6.6 Contract modifications

The standards set out how to recognise modifications to sale contracts, including construction contracts (e.g. additional and reduced work). The relevant provisions aim to ensure that a modification to an existing contract is recognised in accordance with the economic reality of that modification.

A modification to a contract creates new enforceable rights and obligations of the contracting parties or modifies existing rights and obligations. A modification may be made in writing or verbally, or it may be implicit from customary business practices (DAS 270.129).

Depending on the nature of a modification to an existing contract, it is recognised as (DAS 270.130):

a. a separate contract in addition to the existing one;
b. a termination of the existing contract and conclusion of a new one (which incorporates the outstanding performance obligations of the terminated contract); or
c. a modification to the existing contract.

These three recognition methods may also be combined.

Re a.: a separate contract in addition to the existing one
A modification to a contract should be recognised as a separate contract if (DAS 270.130):

- it entails the addition of promised goods or services that are distinct (i.e. the addition of distinct performance obligations as described in paragraph 26.3.1); and
- it increases in the originally agreed consideration by an amount reflecting the value of the additionally promised goods or services.

In assessing whether the second situation applies, appropriate adjustments to that consideration in line with the circumstances of that specific contract are taken into account. For example, an entity may give a discount on the consideration for an additional good or service if that does not involve the selling costs it would have to incur if selling a similar good or service to another customer. In that case, despite that discount, there is still an increase in the original consideration equal to an amount reflecting the value of the additionally promised goods or services.

Another example is additional work on a construction contract that is a distinct performance obligation from the ongoing construction contract, and for which an increase in the consideration for the overall project has been agreed that reflects the value of the additional work. However, if this increase in consideration does not reflect the value of the additional work, then that additional work, together with any remaining part of the original performance obligation, is economically indistinct from the part already performed. In that case, the change is recognised as a modification to an existing contract (in line with c. above).

Example: Modification of a contract for goods; additional products at a price reflecting their value (based on example 5A from IFRS 15)

A BV takes an order to sell 120 products to a customer for 12,000 (100 per product). The products are delivered to customers over a six-month period. After A has delivered 60 products to the customer, the contract is modified and extended to include the delivery of another 30 products (i.e. a total of 150 identical products). These additional 30 products were not included in the original contract.

The contract modification for the additional 30 products increases the total price by 2,850, or 95 per product. The price of the additional products reflects their value at the time of the contract modification and the additional products are distinct (in accordance with DAS 270.109) from the original products.

The contract modification for the additional 30 products is in fact a new and separate contract for future products that does not affect the recognition of the existing contract. A recognises revenues of 100 per product for the 120 products in the original contract and 95 per product for the 30 products in the new contract.

Re b.: the existing contract is terminated and a new one is concluded
A contract modification is recognised as the termination of the existing contract and the conclusion of a new one if (DAS 270.130):

- that modification is not recognised as a separate contract; and
- the remaining goods and services are distinct (i.e. distinct performance obligations as described in paragraph 26.3.1) from the goods or services provided on or before the date of the modification.

The consideration allocated to the remaining promised goods and services is the consideration not previously recognised as revenue from the original contract (i.e. any remaining revenue from the original contract), plus the promised consideration as part of the modification.

Example: Modification of a contract for goods; additional products at a price that does not reflect their value (based on example 5B from IFRS 15)

During the negotiations on the purchase of an additional 30 products, A BV and the customer from the previous example agree on a price of 80 per product (instead of 95). A effectively gives an additional discount based on the expectation that the customer will purchase more products in the future. This lower price could be explained by the fact that there the delivery of the first 60 products was flawed, making the supplier willing to compensate by reducing the price for these additional 30 products.

The price of 80 for these additional products does not reflect their value at the time of the contract modification (which is 95). However, these additional products are distinct (i.e. distinct performance obligations as described in paragraph 26.3.1) from the original ones. Therefore, the contract modification is treated as the termination of the existing contract and the conclusion of a new one.

This implies a blended price of 93.33 (= ((100 × 60 remaining deliverables from original contract)+ (80 × 30 remaining additional deliverables from contract modification)) / 90 remaining deliverables) for each of the 90 remaining deliverables.

Re c.: a modification to the existing contract
A contract modification should be recognised as a modification to the existing contract if (DAS 270.130):

- that modification is not recognised as a separate contract; and
- the remaining goods and services are not distinct (i.e. are not distinct performance obligations as described in paragraph 26.3.1) from the goods or services transferred on or before the date of the modification.

The effect of the change in the transaction price and on the measurement of progress towards satisfaction of the performance obligation is recognised as an adjustment (increase or decrease) to cumulative revenues at the time of the change. This is also known as 'cumulative catch-up'.

This includes, for example, any additional work on a construction contract that is not treated as a separate contract. See the description Re a. Any reduced work agreed is also recognised as a modification of the current construction contract. The effect of any reduced work on the transaction price and on the extent to which the construction contract has been performed is recognised as an adjustment to the cumulative revenues (increase or decrease) when the reduced work is agreed (i.e. cumulative catch-up).

Paragraph 12.4.1 gives an example of a modification that results in a 'cumulative catch-up'.

26.6.7 Interest and dividend

Interest and dividend revenue also only qualifies for recognition when it is probable that the economic benefits will flow to the entity and the amount of them can be reliably determined (DAS 270.131).

Interest and dividend revenue are recognised as follows (DAS 270.132):

- interest revenue is recognised proportionately to time based on the effective interest rate of the asset in question. This implies that interest revenue includes any differences between the initial carrying amount of the interest-bearing investment and the eventual redemption at maturity, for example due to any share premium or discount. When determining interest revenue, straight-line amortisation may be applied as an alternative to the effective interest method if it does not produce a result that is significantly different from that produced by the effective interest method. In the case of zero-coupon loans, for example, straight-line amortisation does not generally provide the understanding required by Article 2:362 NCC;
- dividend revenue is recognised if the entity is entitled to it. See paragraph 9.2.7.

If an interest-bearing investment is still accruing interest when it is acquired, the next interest receipt is allocated to the periods both before and after the acquisition. Only interest allocated to the period after the acquisition is recognised as income. As regards equity investments, if entitlement to dividends is obtained from equity and/or profit or loss already constituted or generated before the acquisition of an investment, those dividends are deducted from the acquisition price of the investment. If this allocation can only be made on an arbitrary basis, the dividends are recognised as income unless it is clear that they are in fact a repayment of the acquisition cost of the investment (DAS 270.133).

26.7 Recognition of sale transactions that include repurchase agreements

The following questions arise when recognising sale transactions that include repurchase agreements:

- has there in fact been a sale? and
- if there has been no sale, how should the transaction be recognised?

The Dutch Accounting Standards Board discusses these questions in more detail in Appendix 2 of DAS 270. It also discusses purchase transactions that include resale agreements. Such purchase transactions are effectively a mirror image of the sale transactions referred to above. This paragraph confines itself to discussing sale transactions that include repurchase agreements.

Has there been a sale?
Essential to answering this question is whether the seller has transferred all significant rights to economic benefits as well as all significant risks and rewards relating to the goods ('risks and rewards') to the customer (DAS 270.110(a)). The economic reality of the transaction should be reflected (DAS 115.107). In determining the economic reality, the entirety of related transactions needs to be considered (DAS 115.108).

How should a transaction be processed if there has not been a sale?
Where a sale transaction based on a repurchase agreement does not involve a sale, that transaction will usually have to be recognised as a combination of an operating lease (selling party = lessor) and a financing agreement (selling party = the financed party). This is effectively a lease contract and not a sale contract, for which the seller receives a lease consideration. In addition, the lessee provides a loan to the seller.

The following entries are made on receipt of payment for this 'sale transaction':

Bank (debit)
Prepaid lease income (credit) (i.e. the difference between the sale amount and present value of the repurchase obligation)
Debt (credit) (i.e. the present value of the repurchase obligation)

The debt is the initial recognition of a financial instrument that is initially recognised at fair value and subsequently measured at amortised cost (see paragraph 21.6). Monthly depreciation charges for tangible fixed assets, lease income and interest expenditure (based on measurement of the debt at amortised cost) are then recognised. Appendix 2 of DAS 270 contains a detailed example of the recognition of such a transaction.

Elaboration on examples of sale transactions
Appendix 2 of DAS 270 includes a diagram of examples of sale transactions based on repurchase agreements. These are shown in the table below. Each type is briefly explained. A fixed price is the price agreed and fixed at the time of the initial sale transaction.

	Variable price: market price on the repurchase date	Fixed price: expected market price on the repurchase date	Fixed price: significantly lower than the expected market price on the repurchase date	Fixed price: significantly higher than the expected market price on the repurchase date
Seller's repurchase right	Sale (1)	Sale (2)	No sale (3)	Sale (4)
Purchaser's resale right	Sale (5)	No sale (6)	Sale, provided that a repurchase is very unlikely or the repurchase amount is insignificant (7)	No sale (8)
Seller's repurchase obligation	Depending on all relevant facts and circumstances (9)	No sale (10)	No sale (10)	No sale (10)

1. The seller has transferred all risks and rewards to the customer. The residual value risk lies entirely with the customer.
2. The seller has transferred the significant risks and rewards, as it does not bear any negative residual value risk, but has the possibility to realise additional benefits in the future. If the fair value at the time of repurchase exceeds the agreed fixed price, the seller will repurchase. It will not do so if the fair value is lower. This means that the consideration received on the sale is an unconditional gain that must be recognised. Any future gain arising from a positive residual value risk is a contingent gain and is therefore not recognised. The actual gain of this contingent gain depends on its future movement in value. If a repurchase takes place, this contingent gain will only be recognised upon realisation (i.e. sale) of the repurchased asset.
3. Because the fixed repurchase price is significantly lower than the expected fair value at the time of repurchase, repurchase is likely. As a result, the seller actually retains a significant amount of the residual value risk, namely the risk that the fair value is lower than expected but still higher than the repurchase price. The conclusion has to be that there is no sale because there is no transfer of virtually all economic benefits and risks.
4. In this situation, the seller is unlikely to repurchase. The seller has transferred all the economic risks and retained only a very limited amount of the economic benefits.
5. The seller has transferred all risks and rewards to the customer. The fact is that the residual value risk lies entirely with the customer.
6. The seller has transferred virtually all the economic benefits to the customer but has still retained some of the economic risks (negative residual value risk). If the fair value at the time of repurchase is lower than the agreed repurchase price, the customer will then sell back to the seller; if the fair value is higher, it will not. Since not virtually all economic benefits and risks have been transferred, there is no sale.
7. The seller has transferred all economic benefits and virtually all the economic risks. The seller bears only a very limited residual value risk, i.e. the risk of the residual value being lower than the agreed repurchase price. In this regard, it needs to be assessed how (un)likely it is that the fair value will be lower than the resale price at the time of repurchase and what the significance of the repurchase amount is compared to the original selling price. If

this assessment shows that the fair value is very unlikely to be less than the repurchase price, or if the repurchase amount is insignificant, the transaction is recognised as a sale.
8. The seller has retained a significant part of the economic risks (negative residual value risk). The fact is that a resale is likely.
9. In principle, the seller has transferred the economic benefits and risks. It is certain, however, that the asset will return to the seller, which means the seller has de facto retained control. Whether there is a sale in this situation depends on an assessment of all the facts and circumstances. Factors such as the time of repurchase and the marketability of the asset in question may be relevant here. If, for example, the repurchase occurs after a significant portion of the asset’s life, it may be concluded that there is a sale, whereas if the repurchase occurs after only a limited part of the asset’s life, this will not be the case.
10. The seller retains most of the economic benefits and risks (in particular the residual value risk) because it is certain that repurchase will take place at a fixed price.

26.8 Net revenue

26.8.1 The concept of net revenue

Net revenue means the revenue from the provision of goods and services arising from an entity's operations less discounts etc. and taxes levied on that revenue (Article 2:377(6) NCC). This means that net revenue reflects the entity's volume of business, i.e. what it generates for its own account and risk by selling and delivering (or transferring ownership) or by providing services to its customers.

The interpretation of the term net revenue should be based on normal, non-incidental business operations (DAS 270.201). It therefore depends on the nature of the business. For example, revenue from waste is part of net revenue if it is a part of the entity's ordinary operations (offsetting against cost is also allowed in situations of minor financial significance). However, if revenue on waste is incidental, it must be recognised under other revenue.

Dividend income and interest income are components of net revenue if they are part of investment income and investments are part of the entity's normal operations. Examples of such entities include pension funds, insurance companies and investment institutions. In addition, under DAS 270.201, investment entities may include dividend income in revenue. We note that if interest income is presented as net revenue and therefore as operating revenue, then interest expenses should in general be presented as operating expenditure. Consequently, interest income and expenses are not presented as part of financial income and expenditure.

In the situation of intermediate holding companies, dividend income and interest income on receivables that are effectively an extension of the intermediate holding company's net investment in its participating interests are not classified as net revenue (DAS 270.201).

In addition, entities working on a commission basis recognise revenue from commissions as revenue and not the transaction value of concluded contracts. Also, where services are provided on a fee basis, only fee revenue is recognised as net revenue. Amounts that an entity receives for third parties are not increases in economic potential and do not increase equity. Therefore, it does not recognise such amounts as revenue (DAS 270.105c).

Example: Net revenue (1)

A Dutch company (hereinafter A) acts as an agent for an English company (hereinafter B). Company A sells goods for company B for a predetermined commission. A handles both invoicing and VAT payments in the Netherlands. Immediately after a sale, A transfers the receivable to B minus its commission payment. B bears any credit risk. The goods are stored in the Netherlands. However, they are capitalised at B. B also bears the economic risk in relation to the goods (e.g. obsolescence).

A only recognises its commission as revenue. The fact is that Article 2:377(6) NCC defines net revenue as revenue from the delivery of goods and services arising from an entity's operations, less discounts etcetera and taxes levied on the revenue. Given that B always bears the risk of loss and obsolescence of the goods, A does not purchase, hold or sell them for its own account and risk. A therefore has no revenue other than commission revenue.

Regular sales of tangible fixed assets also can be deemed net revenue (DAS 270.201), as they arise from normal, non-incidental business operations.

Example: Net revenue (2)

A car leasing company owns a fleet of cars and leases them on the basis of operating leases. The term of an average lease is four years. As a result, the leasing company sells about 25% of its fleet every year. As these sales are part of normal, non-incidental operations, revenue from them is recognised as net revenue. The carrying amount of the cars at the time of sale is recognised as cost of sales.

26.8.2 An entity acting for its own account and risk

As indicated above, net revenue should reflect an entity's operations performed for its own account and risk through sales and deliveries (or transferring ownership) or by providing services to its customers.

The entity must assess its transactions to determine whether and to what extent the amounts it receives are for its own account or for that of third parties. This assessment should consider all the relevant facts and circumstances (DAS 270.105a).

Indicators that amounts are received for an entity's own account (as principal) and are therefore included in net revenue are (DAS 270.105b):

- the entity has primary responsibility for delivering the goods or performing the service;
- the entity controls the goods and services immediately prior to delivering them to the customer;
- the entity bears the inventory risks;
- the entity has direct or indirect freedom of action in setting the price; and
- the entity bears the credit risk on the amount owed by the customer.

According to the Dutch Accounting Standards Board, none of these indicators is a deciding factor in itself.

An entity receives amounts for third parties (as an agent) if it does not have significant rights to economic benefits or bear significant risks in relation to the goods or services provided. It may not recognise such amounts as revenue. An indication that an entity receives amounts for third parties is that the amount that is due to the entity is predetermined, either as a fixed amount per transaction or as a percentage of the amount charged to the customer (DAS 270.105c).

This makes it clear that, if an entity acts for or on behalf of another party and therefore does not itself incur any risks in that regard, the amounts it receives for that are not revenue.

Under IFRS 15, the deciding factor is whether an entity controls the goods and services immediately prior to delivering them. If it does not, the entity is acting as an agent. IFRS 15 uses the same *indicators* to determine whether the entity is the agent or the principal, with one exception. The fifth indicator (credit risk) is no longer mentioned in IFRS 15 because it is of no relevance to control.

Under DAS 270, the distinction between acting as a principal or an agent is determined mainly by an analysis of the benefits and risks. The defining criterion under IFRS 15 (control over the goods and services immediately prior to their delivery to the customer) has been added as an *indicator* for the principal vs. agent assessment.

Given this addition to DAS 270, we believe it is possible to link more closely to the basic premise of IFRS 15. However, this should go hand in hand with an analysis of the other indicators. Two types of criteria can then be derived from the indicators:

- A *risk criterion*, which determines whether the party itself bears the relevant and significant risks relevant to the transaction, such as price risk, inventory risk and credit risk. In this criterion it helps to assume scenarios when assessing which party bears the upside and the downside risks. An agent that does not trade for its own account and risk enjoys far fewer benefits from windfalls compared to (mid-case) scenarios, but it also suffers much less from any worst-case scenarios.

- A *control criterion*, which determines which party makes the decisions relevant and important to the transaction. This aligns with powers with regard to the selection of suppliers as well as in relation to purchasing conditions, inventory policy, pricing policy, decisions regarding changes to the goods or services in question, and gestures of goodwill.

Example: Facilitating the delivery of goods (the entity is an agent) (based on example 45 from IFRS 15)

A.com operates a website where customers can buy goods from a range of suppliers who deliver the goods directly to them. Under the terms of A.com's contracts with suppliers, A.com is entitled to a commission equal to 10 per cent of the selling price of any good purchased through the website. A.com's website facilitates payment between the supplier and the customer at prices set by the supplier. A.com requires payment from customers before processing orders, and orders are unconditional. After A.com has placed the order with the supplier and the supplier has been paid, it has no further obligations towards the customer. The supplier is responsible for satisfying the promise to deliver the goods to the customer.

To determine whether A.com's performance obligation is to deliver the specified goods itself (i.e. A.com is a principal) or to ensure that they are delivered by the supplier (i.e. A.com is an agent), A.com identifies them and assesses whether it receives payments from customers for its own account (as a principal) or on behalf of third parties (as an agent).

The website that A.com operates is a marketplace where suppliers offer their goods and customers buy them. The suppliers deliver these goods to these customers. A.com does not promise any other goods or services to customers.

To determine whether it acts as an agent or principal, A.com examines the indicators given in DAS 270.105b and DAS 270.105c:

- the supplier has primary responsibility for satisfying the promise to deliver the goods to customers. A.com is not obliged to deliver the goods if the supplier does not transfer them to customers, nor is it responsible for whether the goods are acceptable;
- A.com has no control over these goods before they are transferred to customers who order them through the website. At no time is A.com able to determine the use of the goods to be transferred to customers. For example, A.com may not deliver the goods to any other parties or prevent the supplier from transferring them to the customer. A.com has no control over the supplier's inventory of goods used to satisfy orders that customers place through the website;
- A.com assumes no inventory risk at any time, either before or after the goods are transferred to customers. A.com does not undertake to source the goods from the supplier before customers purchase them, nor does it accept responsibility for any damaged or returned goods;
- A.com has no control over pricing of the supplier's goods. The selling price is set by the supplier;
- credit risk does not apply because the goods are prepaid;
- the amount due to A.com is predetermined as a percentage of the amount charged to the customer.

Based on the foregoing, A.com concludes that it is an agent and its performance obligation is to facilitate the transaction and payment between customer and supplier. When A.com satisfies this promise (which, in this example, is when the goods are purchased by the customer), it recognises revenue in the amount of the commission it is entitled to. It therefore does this *before* the supplier delivers the goods to the customer.

Example: Promise to provide services (the entity is a principal) (based on example 47 from IFRS 15)

C.com negotiates with major airlines to purchase tickets at discounted rates compared to the prices the airlines charge customers directly. C.com agrees to buy a certain number of tickets and must pay for them regardless of whether it can resell them. The discounted rate that C.com pays for each ticket is negotiated and agreed in advance.

C.com determines the prices it will charge its customers for the tickets. C.com sells the tickets and collects the consideration from customers upon purchase. C.com requires payment from customers before recognising purchases, and purchases are unconditional.

C.com also helps customers resolve complaints about the airlines' service. However, each airline is responsible for performing the obligations attached to the ticket, including redress for any customer dissatisfied with the service.

To determine whether C.com has the performance obligation to provide the specified services itself (i.e. C.com is a principal) or to ensure that they are provided by another party (i.e. C.com is an agent), C.com identifies them and assesses whether it receives payments from customers for its own account (as a principal) or on behalf of third parties (as an agent).

With each ticket C.com buys from the airline, it acquires the right to a seat on a particular flight (in the form of a ticket) which it then delivers to one of its customers. The service that C.com promises to its customer is this right (i.e. to a seat on a specific flight). C.com does not promise any other goods or services to the customer.

To determine whether it is acting as an agent or principal, C.com considers the indicators given in DAS 270.105b and DAS 270.105c:

- each airline is responsible for performing the obligations attached to the ticket, including redress for any customer dissatisfied with the service. C.com merely helps customers resolve complaints;
- C.com has control over the right to each flight before transferring that particular right to one of its customers. Indeed, C.com is able to determine the use of that right by deciding whether to use the ticket to perform a contract with a customer, and if so, which contract it will perform. C.com also has the option of acquiring the residual benefits from that right by either reselling the ticket and acquiring all revenue from the sale, or using the ticket itself;
- C.com incurs inventory risk in relation to the ticket because it has undertaken to obtain it from the airline before entering into a purchase contract with the customer for that ticket. Indeed, C.com is obliged to pay the airline for this right regardless of whether it is able to find a customer to whom it can resell the ticket or whether it can negotiate a favourable price for it;
- C.com sets the price to be paid by the customer for that ticket;
- credit risk does not apply because the ticket is prepaid;
- the amount to which C.com is entitled is not predetermined but, rather, it depends on the price it obtains for the ticket.

On the basis of the foregoing, C.com concludes that it is a principal in transactions with customers. C.com recognises revenue in the gross amount of consideration to which it is entitled in exchange for tickets it delivers to customers. It does this at the time of delivery to customers.

Taxes and duties

The Dutch Accounting Standards Board has indicated that the same method should be used to determine whether or not taxes other than income taxes are part of revenue (DAS 270.105d). In fact, this is already regulated by law. Indeed, Article 2:377(6) NCC provides that taxes levied on revenue - e.g. value added tax (VAT) - are not part of net revenue. The situation is different for other taxes, however.

Example: Presentation of excise duties in the profit and loss account

Company A imports wines from all the world's well-known wine regions and sells them in the Netherlands. A owes excise duties on this imported wine. As required by the Dutch Tax Administration, the importer has an authorisation for customs warehousing. This means that excise duty is payable when the wines are released (removed) from the customs warehouse. Dutch excise duty is a tax payable on imported or manufactured quantities of product in relation to which the importer or manufacturer incurs significant risks:

- excise duty is also payable on excisable goods that go missing from a customs warehouse as well as on goods that are lost without there being evidence for that;
- the importer or manufacturer is entirely free to include excise duty in its selling prices. For example, goods may be sold below the excise value without any problem. Similarly, an increase or decrease in excise duty need not mean a change in the selling price. This does, of course, have a direct impact on the importer's or manufacturer's profit; and
- there is no arrangement under which excise duty is refunded if the ultimate customer fails to pay the invoice.

Excise duty included in the price charged by the importer or manufacturer to customers is therefore part of that importer's or manufacturer's net revenue. As for foreign excise duties, the situation may again be different, depending on the excise regime in question.

BPM
Car companies and importers receive from customers the Belasting Personenauto's en Motorrijwielen (BPM) charged to them. For financial years beginning on or after 1 January 2023, car companies and importers may no longer present BPM (as part of) net revenue and (as part of) costs or costs of goods sold. Not presenting BPM as net revenue or costs provides a better representation of entities' operations for their own account and risk. The fact is that entities are paid car and motorcycle tax as an agent acting on behalf of the government.

Another requirement is that, if car and motorcycle tax is paid by the car company or importer to the government before the vehicle in question is delivered to the ultimate customer, the entity recognises this prepayment as an asset equal to the tax paid. Consequently, this car and motorcycle tax is not included in the entity's inventory measurement (DAS 270.201a).

26.9 Disclosure

Net revenue disclosure requirements are based on Article 2:380 NCC, which provides:

1. if the organisation of the entity's business is geared towards activities in different sectors, the extent to which each type of those activities contributed to net revenue is stated in figures;
2. net revenue is correspondingly broken down according to the different (geographical) areas in which the entity supplies goods and services;
3. Article 379(4) NCC applies, meaning that the Minister of Economic Affairs may, upon request, grant an exemption from the requirements set in paragraphs 1 and 2. However, this is only granted in exceptional instances.

The composition of net revenue by sector or (geographical) area should be presented numerically, reconciling the net revenue in the profit and loss account (DAS 350.202). If this numerical reconciliation includes internal supplies that are significant for the understanding of the view shown by the breakdown of net revenue, the recommendation is to quantify this (DAS 350.206).

Separate disclosure is in any case required where net revenue in any sector exceeds 10% of total net revenue (DAS 350.203). As regards the concept of a 'sector', the legislator takes its cue from the entity's own internal reporting structure. A sector can, but is not required to, correspond to an operating segment as described in paragraph 30.6 (DAS 350.207).

The required segmentation by (geographic) areas is based on the country of the customer's location or the country in which the service is performed (DAS 350.208). If net revenue in a (geographical) area exceeds 10% of total net revenue, separate disclosure is required.

Additionally, paragraph 30.6 addresses the (voluntary) provision of additional segmented information.

The following should also be disclosed in the notes (DAS 270.601):

- the nature of significant performance obligations;

- for each major type of performance obligation, the method of allocating revenue to reporting periods, including the method of determining the degree of completion of service orders;
- the amount of each significant category of revenue recognised in the profit and loss account in the reporting period, including:
  - revenue from the sale of goods;
  - revenue from services rendered;
  - licensing revenue;
- the amount of revenue arising from exchanges of goods or services included in each significant category of revenue; and
- the total capitalised cost of obtaining a contract.

The entity explains each contingent income and expense in accordance with DAS 252 'Provisions, contingent liabilities and contingent assets'. Contingent income also includes any consideration not yet recognised as revenue due to the entity not being able to reliably determine the amount of revenue (DAS 270.602).

Finally, any change of criteria for differentiation by sectors and for presentation by geographical areas must be disclosed and consequently of the outcome of this detailing, to the extent needed for the reader's understanding.

26.10 Exemptions for medium-sized and small entities

On the basis of Article 2:397 NCC, medium-sized entities are exempt from the segmentation of net revenue provided by Article 2:380 NCC. Furthermore, they have the option of combining items of the profit and loss account (including net revenue) in one 'gross operating profit' item, meaning that they are not required to present net revenue separately. Medium-sized entities using this method of presentation may report the net revenue of each major revenue category as a percentage of total revenue instead of in amounts. They are also exempt from having to explain in the notes the amount relating to the exchange of goods or services included in major revenue categories (DAS 270.601).

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

26.11 Significant differences from IFRS

General
There are significant differences in revenue recognition between (1) DAS 270 'The profit and loss account' and DAS 221 'Construction contracts' and (2) IFRS 15 'Revenue from Contracts with Customers'. IFRS 15 contains provisions for the recognition and disclosure of revenue and related expenses.

In a general sense, DAS 221/270, even after the changes with effect from the 2022 financial year, still maintains a risks and rewards approach for considering whether revenue may be recognised. And IFRS 15 still contains more detailed rules that make the application of IFRS 15 stricter in some instances. In other words, the rules of IFRS 15 leave no room for judgement or further interpretation in some instances. Although DAS 221/270 incorporates elements of IFRS 15, the Dutch Accounting Standards Board emphasises that the provisions of IFRS 15 (including further guidance on its application) are not leading when interpreting DAS 221/270.

Emphasis on control
As regards revenue recognition, IFRS 15 does not explicitly distinguish between sales of goods, rendering of services, construction contracts agreed with third parties and property development. IFRS 15 contains provisions that apply to all promised goods or services. Under IFRS 15, the emphasis is also on transferring control to customers. Revenue is recognised in line with the pattern of transferring control to customers.

The Dutch Accounting Standards do explicitly distinguish between the sale of goods, rendering of services, construction contracts agreed with third parties and property development. Consequently, the classification of a transaction determines the method of revenue recognition. As regards recognition of revenue from goods, DAS 270 places the emphasis on the transfer of benefits and risks from them. In IFRS 15, the transfer of benefits and risks is only one of the indicators for the transfer of control.

Allocation of the contractual transaction price to the contractual performance obligations
Under IFRS 15, if there are multiple performance obligations, the entity must allocate the transaction price in the contract to the performance obligations based on the stand-alone selling price of each of those obligations. The stand-alone selling price is the price the entity would charge if the goods or services were sold separately. DAS 221/270 provides an alternative to allocating the transaction price on the basis of the stand-alone selling price, which is to use the fair value of the performance obligations as the starting point for allocating the transaction price.

Determining the time or period when performance obligations included in a contract are satisfied
According to IFRS 15, an entity recognises revenue at a specific point in time if it satisfies a performance obligation at a specific time. If the entity satisfies a performance obligation over time, the entity recognises revenue over that period. A performance obligation is satisfied over time if one of the following conditions is met:

a. the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs (e.g. providing cleaning services at the customer's premises);
b. the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced (e.g. performing work on the customer's property); or
c. the entity’s performance doesn’t create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for performance completed to date. Throughout the term of the contract, the entity is entitled to an amount that at least compensates it for performance completed to date (including profit margin) if a customer terminates the contract other than the entity's failure to perform as promised. The entity takes into account the terms of the contract and relevant legislation in this regard.

Under the Dutch Accounting Standards, the timing of revenue recognition (at a point in time or over time) depends on the classification of a transaction (sale of goods, rendering of services, construction contract or property development). For recognition of revenue from the sale of goods, the focus is then on transferring the benefits and risks related to these goods.

An entity acting for its own account (as principal) or for third parties (as agent)
Under IFRS 15, the determining factor is whether an entity controls the goods and services in question immediately prior to their delivery. The entity acts as a principal if it controls the goods and services in question immediately prior to their delivery to the customer. If it does not, the entity is acting as an agent. Amounts the entity receives for third parties (as an agent) are not recognised as revenue.

Indicators that the entity controls the goods and services immediately prior to their delivery include:

- the entity has primary responsibility for delivery or performance, for example by being responsible to the customer for the goods or services in question;
- the entity bears the inventory risk; and
- the entity has freedom of action in setting the price, even if indirectly by providing additional goods and services, for example.

Under DAS 270, the distinction between acting as a principal or an agent is mainly determined by an analysis of benefits and risks including credit risk. Under IFRS, credit risk is not relevant to determining whether the entity is acting as a principal or an agent.

Sale transactions that include repurchase/resale agreements
A sale transaction that includes a repurchase/resale agreement is a contract in which the entity sells an asset and also promises, or has an option, (either in the same contract or in another contract) to repurchase the asset or gives the customer the option to resell the asset. IFRS 15 bases recognition on the ongoing transfer of control from seller to customer. This means that in situations where the customer has the obligation (or can be obliged) to return the asset, control is not transferred but, instead, the customer has the right to use that asset for a certain period (lease). Recognition of sale transactions that include repurchase/resale agreements under DAS 270 is based on the transfer of the principal benefits and risks associated with the goods in question as discussed in paragraph 26.7.

27 Borrowing costs

27.1 Introduction

If an entity raises debt, which it will usually do in the form of a long-term or short-term loan, in nearly all instances it will have to pay interest on this loan. These interest payments and other costs associated with obtaining and holding the debt constitute the borrowing costs referred to in this chapter. Borrowing costs are costs to be incurred for making a particular loan available, as well as other related costs (DAS 273.0). As a rule, the interest rate is a fixed or variable rate per year on the principal of a loan. Furthermore, one-off and periodic payments are made that are either partly intended as interest payments or are so closely related to financing that treatment in the financial statements as 'borrowing costs and similar expenses' is acceptable.

Examples of borrowing costs and similar expenses are (DAS 273.104):

- premiums and discounts and their amortisation;
- repayment premiums;
- issuing fees;
- one-off costs in the event of early repayment (penalties);
- additional costs incurred for arranging the financing;
- exchange rate differences to the extent that they qualify as an adjustment of borrowing costs; and
- borrowing costs included in the lease instalment in the case of finance leases.

Distributions to holders of financial instruments that the issuing entity has classified as equity are not recognised as borrowing costs. These distributions are deducted directly from equity as part of the profit appropriation and, as a result, do not constitute borrowing costs as described in this chapter.

The discussion in this chapter does not apply to entities such as banks, whose main activity is the provision of financing.

27.2 Recognition

Borrowing costs and similar expenses
Borrowing costs are allocated to the subsequent reporting periods in proportion to the remaining principal, unless they are capitalised (DAS 273.201). Periodic borrowing costs and similar expenses, such as overdraft fees and commitment fees, must be charged to the year for which they become due (DAS 273.201). This means that when interest and fees are allocated, it is not the reporting period of the interest payment that is decisive, but the reporting period in which the remaining principal is outstanding or the financial service is received, respectively. This is also consistent with the measurement at amortised cost of loans and borrowings subject to the effective interest method (see section 21.1).

In some cases, no relationship can be established with the principal actually drawn down. An example is commitment fees, where a fee is paid for a credit facility that gives the user the right to draw credit up to a certain limit for a certain period of time. Such fees must be paid even if the user does not draw credit under this facility. The fee serves as compensation for the costs the bank incurs for raising capital to fulfil the credit commitments, as such facilities count towards the maximum credit risk for the bank.

Example: Payment of a credit facility fee

In order to refinance a number of loans to be repaid within a short period of time, a credit facility is agreed between company A and bank B under which A is allowed to draw an amount of 1,000,000 for five years on condition that certain covenants are met during the facility period. Loans drawn under this facility carry arm's length interest rates. The fee for the facility is 20 basis points (0.2 per cent) per year, which is fully paid in advance. This means that the fee paid at the start of year 1 is 10,000 (= 0.2% x 5 x 1,000,000). This commitment fee is recognised under prepayments and accrued income, after which 2,000 is allocated to each year over the term of the facility and presented under borrowing costs and similar expenses.

Penalty interest
Some loan contracts allow for early repayment incurring payment of penalty interest. This interest is generally to be regarded as compensation for costs the counterparty (the bank) incurs to adjust its interest rate hedge and as compensation for the interest margin it has lost for the remaining term of the loan. The latter means: the shorter the remaining period to the repayment date, the lower the penalty interest, as the bank's lost interest margin is calculated over a shorter period of time. The borrower usually does not know in advance whether they will use this facility and whether they will be willing to pay this penalty interest. That is why, for loans measured at amortised cost to determine the effective interest rate (see section 21.1), any early repayment and associated penalty interest are generally disregarded when the loan is taken out. The determination of the effective interest rate is then based on the assumption that the loan is repaid on the contractual date. As the penalty interest is not included in the effective interest rate and only results from the decision during the term of the loan to make early repayments, we believe the penalty interest should be recognised as an expense in the reporting period in which the repayment is actually made and the loan is derecognised. The penalty interest is recognised in interest and similar expenses. If the amount of the penalty interest is material and is to be considered an exceptional item, it must be disclosed in a separate note. See section 23.7.

Interest capitalisation
The construction cost at which an asset to be recognised in the balance sheet is measured may include interest (Article 2:388(2) NCC), which means that capitalising interest is not mandatory. Only interest payable on debt may be capitalised. This capitalisable interest relates to the period attributable to the production of the asset, which must be a qualifying asset. Qualifying assets are assets that necessarily require a significant amount of time to make them ready for use or sale (DAS 273.0). Examples of qualifying assets are newly constructed property or inventory that will take significant time to bring into marketable condition.

Moreover, the decision whether or not to capitalise this interest needs to be based on a consistent policy; consequently, the decision to consider this interest to be part of the production cost or to exclude it from the construction cost applies to all qualifying assets (DAS 273.206).

If borrowing costs are included in the construction cost, this interest must be calculated on the basis of the interest payable on the loans drawn specifically for production less any investment income obtained from temporary investments of the loans drawn. To the extent that the production is financed by loans that are not specifically attributable to the production of certain assets, the interest item to be capitalised must be calculated by multiplying the weighted interest rates of those loans by the production expenditures, taking into account the period of production. In this context, the amount of production expenditures covers the amounts allocated to production, less any instalments received from customers and any government grants and similar facilities received by virtue of the investment in the relevant asset item. The amount of interest to be capitalised and calculated in this way may not exceed the actual borrowing costs due for that period (DAS 273.207).

Example: Interest capitalisation

A company intends to relocate to a new building to be constructed, with the existing building being sold when it becomes vacant. The sale price of this building to be sold will not be received until the transfer of title, but instalments will usually have to be paid to the contractor constructing the new building during the construction period. If these instalments are financed with outside capital, a direct relationship can be established between the interest payable on this temporary financing and the production cost of the new building to be constructed. The company may choose to include the interest in the production cost.

When the old building is sold and the sale price is received, it will be used to repay the temporary financing. Once the new building is completed, interest cannot be capitalised any longer.

Payment discounts
A situation may arise where payment discounts are granted to customers on immediate or early payment. This may be treated in either of two ways (DAS 273.202):

1. recognising the payment discount as borrowing costs;
2. deducting the payment discount from revenue.

In general, if customers frequently use payment discounts, presentation as a deduction from revenue is the most suitable option (DAS 270.202). Where customers occasionally use these payment discounts, presentation as borrowing costs is more obvious.

Supplier credit
In case of additional costs associated with the above-average use of supplier credit, these additional costs are not considered part of the purchase price but are recognised as borrowing costs.

Premiums, discounts and transaction costs
Premiums and discounts are positive and negative differences, respectively, between the amount received from the lender and the principal acknowledged as debt at the time the loan was taken out (i.e. the nominal value). Such a difference may arise if the nominal interest rate of the loan differs from the market rate and is reflected in the amortised cost (amortisation value) of the loan. Transaction costs are also included in the amortised cost of a loan. These are all costs directly attributable to the acquisition, issue or disposal of a financial instrument. Premiums, discounts (as well as repayment premiums) and transaction costs are allocated to the successive reporting periods as borrowing costs. This allocation must take place in such a way that, together with the interest payable on the loan, the effective interest is annually recognised in the statement of profit or loss and the amortised cost (amortisation value) of the debt is recognised in the balance sheet as a net amount (DAS 273.201). This means that premiums and discounts are allocated to the periods using the effective interest method, ensuring a systematic allocation of these items to be charged or credited to the statement of profit or loss. Incidentally, linear amortisation is permitted as an alternative when determining amortised cost, if linear amortisation does not give rise to significant differences compared to the application of the effective interest method (DAS 273.201). There are various options for the presentation of premiums or discounts in the balance sheet (see section 27.3).

27.3 Presentation and notes

Presentation of borrowing costs and similar expenses
Under Article 2:377(3)(o) and Article 2:377(4)(k) NCC, borrowing costs and similar expenses are recognised separately in the statement of profit or loss. Similar expenses include the items stated in section 27.1 and section 27.2, such as issuing fees, early repayment penalties, and overdraft and commitment fees.

Classification as interest or dividend depends on the nature of the financial instrument
Interest relating to a financial instrument or a component of such an instrument that is presented as a financial liability must be recognised as an expense in the statement of profit or loss. The entity must recognise distributions to holders of equity instruments directly as a deduction from equity, net of any related income tax benefit (DAS 290.821).

Presentation of premiums, discounts and repayment premiums in the balance sheet
Premium amounts not yet recognised in the statement of profit or loss and repayment premiums already recognised in the statement of profit or loss must be recognised as an increase in the debt to which they relate (DAS 273.201). It is recommended that discount amounts not yet recognised in the statement of profit or loss be shown as a reduction in the debt to which they relate. However, Article 2:375(5) NCC permits capitalisation of the discount as a separate accrued item instead of deducting it from the relevant debt.

Capitalised interest
If interest has been capitalised, this must be disclosed in the notes (Article 2:388(2) NCC). The note to the borrowing costs item discloses the amount capitalised over the year and also states the interest rate used to calculate the interest to be capitalised (DAS 273.302).

27.4 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

For balance sheet presentation purposes, small entities have the option of presenting the premium amounts not yet recognised in the statement of profit or loss and the repayment premiums already recognised in the statement of profit or loss separately in the balance sheet as accruals and deferred income rather than recognising them as an increase in the related debt (DASsmall B16.104).

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

27.5 Significant differences from IFRS

Interest capitalisation

IAS 23 'Borrowing Costs' does not allow the immediate recognition of interest as an expense to the extent that it relates directly to the acquisition, construction or production of a qualifying asset. This interest must be capitalised under IAS 23. Pursuant to Article 2:388(2) NCC and DAS 273, capitalising interest related to the acquisition, construction or production of a qualifying asset is permitted but not required.

28 Share-based payments

28.1 Introduction

DAS 275 'Share-based payments' contains provisions on the recognition of share-based payments. A share-based payment is a transaction in which an entity receives goods or services in exchange for a consideration in shares (or other equity instruments, including share options) of the entity, or for consideration in cash based on the price or value of the entity's shares (or an entity belonging to the same group as the entity).

The recognition of share-based payments in the financial statements is therefore based on the premise that an entity receives resources (services or goods) in exchange for these payments. The increase in these resources should be recognised, with equity being recognised as settled in shares, or a liability being recognised as settled in cash. At the time of receipt of the resources or at a later date, the company must recognise the consumption of those resources as costs. If the reality is that share-based payments have a value and are meant to motivate and compensate management board and employees for their services, then reporting should reflect this reality.

For the recognition of share-based payments, DAS 275 distinguishes between transactions with employees and other transactions. For other transactions, the fair value of the goods or services received should in principle be determined, unless this fair value cannot be reliably determined. In contrast, in transactions with employees, the transaction value is determined based on the value of the entity's granted equity instruments. And as a further simplification, for the measurement of share options granted to employees, intrinsic value may be used instead of fair value. The reason for the distinction between transactions with employees and other transactions is that it is assumed that it is not possible to reliably determine the value of the work performed (DAS 275.302). We emphasise that the other provisions applicable to transactions other than with employees also apply to transactions with employees.

28.2 Scope of DAS 275 Share-based payments

DAS 275 'Share-based payments' addresses the recognition, measurement, presentation and disclosure of share-based payments. However, DAS 275 does not apply to (DAS 275.103):

- a transaction with an employee of an entity (or any other party) in the capacity of shareholder (or holder of other equity instruments) of the entity;
- a transaction in which an entity acquires goods as part of a merger or acquisition, as defined in DAS 216 'Mergers and acquisitions';
- a (contribution) transaction between entities under common control, including the contribution transaction that takes place upon incorporation of the entity;
- a transaction in which an entity receives goods or purchases services under a contract to buy or sell non-financial assets (commodities), where each party has the right to settle on a net basis in cash or another financial instrument or by exchange of financial instruments; and
- the recognition of share-based payments initiated or settled by a person or company that is not part of the consolidation scope of an entity (intra-group share-based payments) (DAS 275.103a).

Transactions with employees in the role of shareholders

Under DAS 275, a transaction with an employee (or any other party) in its capacity as a shareholder of an entity is not a share-based payment. For example, an entity may give all holders of a certain class of shares of the entity the right to acquire additional shares of the entity at a price lower than the fair value of those shares. If an employee receives such a right because they hold shares of that particular class, the granting or exercise of that right is not subject to the requirements of DAS 275.

Example: Transactions with employees in the role of shareholders

An entity buys back its own shares from employees. The entity pays an amount equal to the fair value of these shares. This transaction should be regarded as a repurchase of own shares. DAS 275 does not apply to this transaction. However, if the entity paid these employees an amount higher than the fair value of the shares at the time of repurchase, there is a remuneration element. DAS 275 does then apply.

Transactions as part of acquisitions and mergers
DAS 275 applies to share-based payments where an entity acquires or receives goods or services. Goods include inventories, consumables, tangible fixed assets, intangible assets and other non-financial assets. However, an entity does not apply DAS 275 to transactions where the entity acquires goods as part of an acquisition or merger as defined in DAS 216 'Mergers and acquisitions'. Hence, shares issued in an acquisition in exchange for control of the acquired entity are not within the scope of DAS 275.

However, shares granted in an acquisition to employees of the acquired entity, in their capacity as employees (e.g. in exchange for the continuation of their employment), do fall within the scope of DAS 275. Similarly, the cancellation, replacement or other modification of share-based payment contracts in connection with a business combination, or other equity restructuring, should be recognised in accordance with DAS 275.

(Contribution) transactions under common control
A (contribution) transaction between entities under common control, including the contribution transaction that takes place upon incorporation of an entity, does not fall within the scope of DAS 275. For the recognition of such transactions, see paragraph 31.6.

Financial instruments
DAS 275 does not apply to share-based payments where an entity receives or purchases goods or services under a contract that falls within the scope of DAS 290 'Financial Instruments'. An example is commodity contracts to buy or sell non-financial assets in exchange for a share-based payment, where each party has the right to settle on a net basis in cash or another financial instrument or by exchange of financial instruments. Such contracts fall within the scope of DAS 290. Commodity contracts may have been entered into in connection with the receipt or delivery of a non-financial item in accordance with an entity's expected purchases or sales or usage requirements. Such contracts are referred to as 'executory contracts'. Executory contracts are not recognised on the balance sheet. Only if an executory contract is loss-making a provision is recognised under DAS 252.

Example: Relationship between DAS 290 and DAS 275

Private limited liability entity A entered into a commodity forward contract whose payment is based on 1,000 A shares. A can settle the commodity forward contract by receiving the goods. However, A intends to resell the commodity forward contract as such to a third party. A can do so because both A and the other party have the right to waive the supply of goods and instead settle the net value of the contract between themselves. The measurement of the aforementioned contract falls under DAS 290. However, if A does intend to receive the goods, then the measurement of the goods received falls under DAS 275. The contract as such is not recognised on the balance sheet as it is an executory contract.

Share-based payments within a group
DAS 275 need not be applied for the recognition of share-based payments initiated or settled by a person or company not included in the consolidation scope of the entity (DAS 275.103a). For example, if a holding entity has granted a share option scheme to employees of an operating entity and that scheme is also settled by that holding entity, the operating entity does not have to recognise the scheme in its financial statements. Incidentally, the operating entity may choose to do so. The operating entity must make a choice in this and apply it consistently. For further explanation, please refer to paragraph 28.10. These are also related party transactions that may need to be disclosed (DAS 275.511).

28.3 Equity-settled and cash-settled transactions

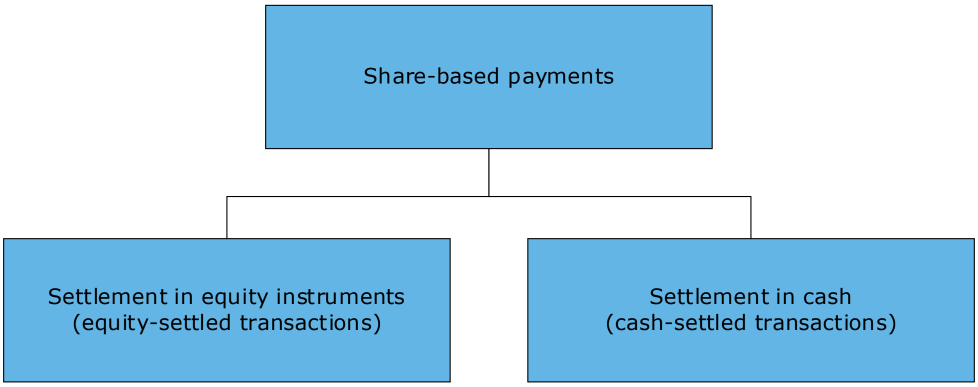
A share-based payment is a transaction in which the entity receives goods or services:

- in exchange for a consideration in shares (or other equity instruments, including share options) of the entity or an entity belonging to the same group as the entity (equity-settled transactions); or
- for which an amount is paid based on the price or value of the shares (or other equity instruments) in the entity or an entity belonging to the same group as the entity (cash-settled transactions).

The former involves settlement in equity instruments, while the latter involves settlement in cash. Examples of share-based payments are (DAS 275.102):

- a payment to a supplier through the provision of shares;
- an acquisition of assets in exchange for new or existing shares;
- share and share option schemes for employees;
- bonus payments based on the change in value of the entity's shares such as 'share appreciation rights' (see example below) and 'phantom shares' (a bonus payment based on the change in value of an imaginary basket of the entity's shares); and
- equity instruments granted to employees of the acquiree or merging party in their capacity as employees in a merger or acquisition.

Scheme: Share-based payments



Example: Share appreciation rights (SARs)

An entity may grant so-called share appreciation rights (SARs) as part of its employee remuneration package. These are conditionally granted rights to a cash payment whose amount is determined as if the rights were share options. Entitlement to the payment may be conditional on the achievement of certain predetermined performance conditions.

28.4 Recognition basics

The recognition of share-based payments depends on the method of settlement (equity-settled or cash-settled). The debit entry is the same for both methods of settlement. The credit entry, on the other hand, depends on the method of settlement.

What is debited?
An entity should recognise the goods or services received or acquired in a share-based payment when the goods are acquired or as the services are rendered. When those goods or services do not qualify for recognition as assets, they are recognised as an expense. This applies to both equity-settled and cash-settled transactions.

What is credited?
The credit entry in cash-settled transactions is the recognition of a liability. This liability is derecognised when payment is made.

The credit entry in equity-settled transactions is an increase in equity. DAS 275 does not specify whether a separate reserve should be recognised for these increases. In practice, it is common to recognise a separate reserve. It is also defensible to recognise the increase in Other reserves or in Share premium. If a separate reserve is recognised, this reserve is transferred to Other reserves or to Share premium when the transaction expires. The expiry of the reserve therefore does not take place through the profit and loss account because the credit entry is actually a deposit of shares (equity). If there is a transfer to Share premium, however, it should be checked whether the share premium is recognised for tax purposes because of the requirement to disclose the share premium that is not recognised for tax purposes (DAS 240.218). Since tax recognition as paid-in share premium will often not be considered, transfer to Other reserves seems more obvious.

28.5 Vesting

General
Vesting means 'becoming unconditional' or 'becoming an entitlement'. Under a share-based payment, the right of another contracting party to receive cash, other assets, or equity instruments of an entity vests when any specified conditions (vesting conditions) are met. The vesting period is the period during which all conditions for vesting (vesting conditions) must be met.

> ***Example: Vesting***
>
> If an employee is granted share options on the condition that they remain employed for at least three years, the vesting period is three years. The scheme then requires the employee to provide labour services during this three-year vesting period as consideration for share options in the future. After the employee has continued to be employed for three years, the share options become unconditional ('vested').

Vesting conditions
Vesting conditions are the conditions that must be met before the other contracting party becomes entitled to receive cash, other assets or equity instruments of an entity under a contract. Vesting conditions include performance-related and price-related conditions, according to DAS 275. Performance-related conditions include conditions related to the service period, pursuant to which the other contracting party must have provided services for a certain period ('service conditions'), and conditions, pursuant to which certain performance targets must be achieved ('performance conditions'). Performance conditions must also include a service condition. Performance-related conditions determine whether an entity receives the services in exchange for the share-based payment. In other words, there is a relationship between the services to be performed (by employees, for example) and the share-based payment.

A price-based condition is a condition whose exercise price, vesting or exercisability depends on the price or value of an entity's equity instruments. Price-related conditions are taken into account in determining the fair value of share-based payments on the grant date. With price-related conditions, there is no relationship between services to be received by an entity and the share-based payment.

> ***Example: Vesting conditions***
>
> Examples of performance-related conditions:
>
> - an employee is granted shares on the condition that the employee remains employed for three years (a service condition); and
> - an employee is granted shares on the condition that revenue increases by a certain percentage over a certain period during which the employee is employed by an entity (a performance condition).
>
> Examples of price-related conditions include:
>
> - reaching a certain share price;
> - reaching a certain intrinsic value of a share option; and
> - reaching a specified goal based on the market price of an entity's equity instruments relative to an index of market prices of other companies' equity instruments.

Non-vesting conditions
Non-vesting conditions are all those conditions that do not meet the definition of vesting conditions. Therefore, a non-vesting condition does not affect when the other contracting party (e.g. employee) becomes entitled to receive cash, other assets or equity instruments of an entity. Non-vesting conditions are taken into account in determining fair value on the grant date. This is in contrast to performance-related conditions (service conditions and performance conditions).

Example: Non-vesting conditions

Examples of non-vesting conditions are:

- stipulation that the employee must make certain contributions before qualifying for share-based payment (relates to pre-vesting period); and
- restriction on the transfer of acquired shares (post-vesting) to third parties (relates to post-vesting period).

28.6 Recognition and measurement of transactions other than share-based payments provided to employees

28.6.1 Introduction

An entity should recognise the goods or services received from a share-based payment when it obtains the goods or as the services are rendered (DAS 275.202). In principle, recognition takes place in the profit and loss account unless the conditions for recognising an asset are met. Settlement of a share-based payment can be in equity instruments (equity-settled) or in cash (cash-settled). Settlement in equity instruments results in an increase in equity. Settlement in cash results in the recognition of a liability.

28.6.2 Settlement in equity instruments (equity-settled)

A share-based payment settled in equity instruments in exchange for goods or services received, and the corresponding increase in equity, shall be recognised at the fair value of the goods and services received, unless that fair value cannot be measured reliably. If the fair value of the goods or services received cannot be measured reliably, an entity shall recognise the payment based on the fair value of the equity instruments granted (DAS 275.203). The fair value of goods and services received or the fair value of equity instruments granted shall be determined on the measurement date. Changes in the value of equity instruments after this measurement date should not be recognised (DAS 275.204).

Example: Equity-settled transaction

BV B obtains goods from its supplier in exchange for the delivery of 100 BV B shares with a face value of 10 per share. The fair value of the goods is 25,000. The recognition is as follows:

Inventory	25,000	
Share capital		10,000
Share premium reserve		15,000

Goods and services cannot be specifically identified
An entity must recognise the goods and services received from a share-based payment when it obtains the goods or as the services are rendered (DAS 275.202). If the fair value of equity instruments granted exceeds the fair value of goods and services received, this is an indication that not all goods or services received may have been identified. However, in share-based payment transactions, an entity may not be able to specifically identify some or all of the goods or services received. Under NL GAAP, there is no specific guidance on how to deal with such situations. Under IFRS, provisions do exist for such situations. Under DAS 110.110, we consider these provisions applicable. IFRS 2 states that if there are no specifically identifiable goods or services, other circumstances may indicate that goods or services have been or will be received. Any identifiable consideration received may be less than the fair value of the equity instruments granted or liability assumed. This circumstance usually indicates that some other consideration, unidentifiable goods or services, have been or will be received. The entity must determine the value of the identifiable goods or services received (or to be received) in accordance with the provisions for share-based payments. An entity determines the value of unidentifiable goods or services received (or to be received) on the difference between:

- the fair value of the equity instruments granted or liability assumed; and
- the fair value of any identifiable goods or services received (or to be received).

An entity must determine the value of unidentifiable goods or services received on the grant date. For cash-settled transactions, the value of the liability must be remeasured at the end of each reporting period until the liability is settled.

Example: Fair value of equity instruments granted higher than fair value of goods received

Suppose the value of the shares mentioned in the previous example is 30,000. In that case, a critical look should be taken at whether all goods and services obtained have been identified. Inventory may need to be recognised for 30,000 or it may need to be established that other services or goods will also be received in the amount of 5,000. However, if after this assessment it is found that only goods with a fair value of 25,000 have been obtained, the entry in the previous example remains in force.

Example: Goods and services cannot be specifically identified

An entity issues shares with a total value of 100,000 to third parties. These third parties are not employees but charities. The aim is to improve the company's image in the context of corporate social responsibility. This image enhancement can lead to several economic benefits, such as increased brand awareness, improved position to recruit and retain highly skilled employees or increased chances of concluding sales contracts with clients.

The entity is unable to specifically identify the consideration. The identifiable consideration (nil) is lower than the fair value of the shares issued (100,000). This indicates that services have been or will be received. On this basis, DAS 275 applies. The entity measures the services received based on the fair value of the shares issued. The entity makes the following entry:

Costs	100,000	
Equity		100,000

28.6.3 Settlement in cash (cash-settled)

Goods and services received in exchange for a cash-settled share-based payment and the corresponding liability should be recognised at the fair value of the liability. On each reporting date and on the settlement date, the liability should be remeasured at its fair value until settlement. Any changes in the fair value of the liability should be recognised in the profit and loss account (DAS 275.205).

Example: Cash-settled transaction (1)

BV C acquires a truck with a fair value of 75,000 on 30 November of year 1. Payment will be made on 1 February of year 2. The fair value of 100 BV C shares on 30 November is also 75,000. The face value of one BV C share is 25. The payment is based on 100 BV C shares, but will be settled in cash on 1 February of year 2.

The following entry is recognised in year 1:

Tangible fixed assets	75,000	
Liability		75,000

The value of 100 BV C shares on 31 December of year 1 is 80,000. At the end of year 1, the liability is then increased by 5,000 and taken to the profit and loss account. The change in liability is recognised as follows:

Profit and loss account	5,000	
Liability		5,000

On 1 February of year 2, the value of 100 BV C shares is still 80,000. The settlement of the liability is recognised as follows:

Liability	80,000	
Bank		80,000

According to DAS 275.205, changes in the fair value of the liability should be recognised in the profit and loss account. In DAS 275 there are no provisions as to under which item in the profit and loss account the change in fair value of the liability is recognised. We believe that it is preferable to recognise this change in a separate item under financial income and expenses by virtue of the specific fact that settlement in cash actually takes place on the basis of a basket of notional shares three months after the delivery of the asset.

28.6.4 Alternatives for settlement

The other contracting party has right of choice of settlement
An entity may have granted the other contracting party the right to determine whether a transaction is settled in cash. In that case, therefore, the entity may be required by the counterparty to settle the share-based payment in cash and the transaction should be recognised as a cash-settled share-based payment (DAS 275.206).

A special situation may arise in this context if the fair value of the settlement in shares is higher than the settlement in cash for which a liability should already be recognised. Assuming the counterparty acts economically rationally, it will, after all, choose the most profitable settlement alternative. If the settlement in cash is worth more than the settlement in own shares, nothing further needs to be recognised as the liability is already based on the payment in cash. However, in the situation where the fair value of the settlement in shares is higher than the settlement in cash, the DAS indicate that the equity component (i.e. the difference between the fair value of the total promise and the fair value of the promise upon settlement in cash) and the liability should be recognised separately (DAS 275.207).

This therefore means that the debit entry (cost item unless recognised as an asset) is based on the highest value of the settlement alternatives. The portion that exceeds the value of the liability (if any) is thus recognised in equity. If the payment is based on the fair value of the equity instrument (including the intrinsic value of an option), this situation will not occur, because in that case both alternatives have or will have the same value at settlement.

Entity itself has right of choice of settlement
If an entity has a choice under the contract to settle in cash or equity instruments, the entity should determine whether it has a constructive obligation to settle in cash. An entity has an obligation to settle in cash if the alternative settlement option has no economic substance. For example, because the entity may not legally issue shares. Or it is common practice or established policy for the entity to settle in cash. Or the entity generally settles in cash when the other contracting party requests settlement in cash. There is then a constructive obligation. If such a constructive obligation exists, the transaction should be recognised as a cash-settled share-based payment (DAS 275.208).

If it is concluded that an entity has the right but not the obligation to settle the share-based payment in cash, the transaction should be recognised as equity-settled (DAS 275.206). If an entity has the right and not the obligation to settle the share-based payment in cash, any cash payment is charged to equity (DAS 275.209). Such recognition is similar to the recognition of a share buyback. When it comes to final settlement by issuing equity instruments, an entity only recognises an entry between equity components.

Conditional settlement alternatives
The manner of settlement of share-based payment transactions may depend on events over which both an entity and the employee have no control. Share-based payments that classify as equity-settled may include a conditional settlement alternative. For example, settlement in cash will take place in case of a change of control of an entity. DAS 275 does not include guidance on how to classify such share-based payments. IFRS 2 does not include any provisions on this either. DAS 290 'Financial Instruments' (and IAS 32 'Financial Instruments; Presentation') do contain provisions for the classification, as either equity or liability, of financial instruments with a conditional cash settlement alternative. However, the IASB has concluded that the provisions of IAS 32 should not be applied in IFRS 2 (see IFRS 2.BC106-110 and IFRS 2.BC266). As a result, under IFRS an entity cannot rely on IAS 32 to determine the classification of a share-based payment under IFRS 2. For classification, when applying this further IFRS guidance under NL GAAP, there is nothing left but to apply the provisions for contingent liabilities under DAS 252 on provisions and contingent liabilities. The decisive question is whether the event over which both an entity and an employee have no control is probable. As long as the event is not probable, an entity recognises the share-based payment as equity-settled. From the moment the event does become probable, an entity recognises the share-based payment as cash-settled. This assessment should be made on the grant date and then continuously as stipulated in DAS 252.513 for contingent liabilities. Thus, after the grant date, the classification may change from equity-settled to cash-settled. This happens as a result of, for example, the change of control of an entity's becoming probable. In that case, the entity recognises this change in a similar way to a change from equity-settled to cash-settled (see paragraph 28.8.5.3).

28.7 Special aspects of share-based payments provided to employees

28.7.1 Basic methods for recognising share-based payments provided to employees

General
Share-based payments provided to employees are recognised at the fair value of the entity's equity instruments granted in accordance with the principles set out in paragraph 28.6, and not at the fair value of the services received (the work performed). This is because it is assumed that it is not possible to reliably determine the value of the work performed (DAS 275.302).

However, when it comes to the recognition of share options granted to employees, recognising them at intrinsic value is also permitted. For this purpose, an entity must opt for recognition based on either the fair value of the share option or the intrinsic value of the share option (DAS 275.314). This applies to both equity-settled and cash-settled share-based payments.

In a grant of share options, the share-based payment is finally settled when the options are exercised, surrendered (e.g. upon termination of the employment contract) or lapse (e.g. at the end of the option's term). The entity bases the expenses to be recognised for employee benefits on the number of share options ultimately exercised. For the purposes of this requirement, the entity will recognise the work performed during any vesting period. An entity bases the recognised expense related to that work performed on the number of share options that are expected to vest. An entity adjusts this estimate if subsequent information indicates that the number of share options expected to vest differs from the previous estimate. On the vesting date, an entity revises the estimate according to the number of share options ultimately exercised.

After the vesting date has passed, an entity reverses the employee benefits recognised for the work performed if the share options are ultimately not exercised. This results in a benefit in the period of reversal equal to the employee benefits recognised in previous periods. Viewed over the entire period of the share option scheme, this does not lead to any employee benefit or expense, which corresponds to the fact that ultimately no share options are exercised.

Appendix 1 of this chapter includes a comprehensive example of the recognition for share options granted to employees, illustrating the accounting based on both fair value and intrinsic value.

Recognition of share options granted to employees on an intrinsic value basis
When recognising share options granted to employees on an intrinsic value basis, the so-called time or expectation value is not taken into account on measurement of the share option. The intrinsic value of a share option should be determined as the positive difference between the fair value of an entity's underlying share and the exercise price. For determining the fair value of the underlying share, see paragraph 28.11.4.

If an entity elects to recognise the share options on an intrinsic value basis, regardless of the method of settlement, the intrinsic value should be determined on each reporting date and on the settlement date. Any change in intrinsic value should be recognised in the profit and loss account. This means that on each reporting date, the intrinsic value is determined and recognition takes place on this basis (DAS 275.314).

Fair value recognition of equity-settled share-based payments; the grant date model
If it is not intrinsic value but fair value that is the policy for measurement of an equity-settled share-based payment, the question of when to determine this fair value is particularly important. Indeed, during the vesting period, the value of the share-based payment to the employee will depend on the share price trend. Copying IFRS 2, the DAS prescribe the grant date model. This is particularly evident from the definition of measurement date in DAS 275.0, that being:

The date on which the fair value of the equity instruments granted is determined.

Furthermore, this definition states:

In the case of transactions with employees and others providing similar services, this date is the grant date. In all other cases, the measurement date is the date the entity receives the goods or services.

So this is an important difference from cash-settled share-based payments where in fact every reporting date during the vesting period is a measurement date. After all, the liability should be determined based on the best estimate of cash outflows. In an equity-settled share-based payment, we only determine the fair value of the equity instruments granted at one point in time and that is on grant date. Therefore, in the hypothetical case that a day after grant date, the entity's share price permanently collapses, this has no effect on the expense allocation over the vesting period. However, it does take into account the expected number of equity instruments that will eventually vest at the end of the vesting period. For an elaboration of this model, see the example 'Effect of performance-based conditions on equity-settled transactions' in the next paragraph.

28.7.2 Specific aspects of share-based payments provided to employees

A number of aspects in share-based payments provided to employees deserve specific attention. These aspects are (DAS 275.301):

- inability to reliably determine the fair value of the work performed;
- the effect of performance-related conditions;
- the effect of price-related conditions;
- taxes;
- amendments to the conditions under which share-based payments are granted (see paragraph 28.8); and
- cancellation and settlement of share-based payments (see paragraph 28.9).

Inability to reliably determine the fair value of work performed
An entity should recognise the share-based payment in transactions with employees based on the value of the equity instruments granted and therefore not based on the value of the work performed. This is because it is assumed that it is not possible to reliably determine the value of the work performed (DAS 275.302). Annex 1 to this chapter contains an illustrative example of the recognition and measurement of share-based payments in transactions with employees.

Impact of performance-related conditions
If no performance-related conditions have been agreed, an entity should assume that the work performed by the employees has already been performed as consideration for the share-based payment. An entity must recognise the work performed in full on the grant date with a corresponding increase in equity or liability, depending on the method of settlement (DAS 275.303).

If performance-based conditions have been agreed, the value of the share-based payment should be allocated on a straight-line basis to the periods in which the performance is performed (the so-called vesting period). Ultimately, the cumulative amount of the expense is based on (the portion of) the share-based payment that vests. This means that on a cumulative basis, no expense for work performed and received is recognised if the grant of equity instruments does not vest because one or more performance conditions for vesting are not met (DAS 275.304).

Example: Impact of performance-based conditions on equity-settled transactions

An entity grants 100 share options to 200 employees on 1 January of year 1. Each share option gives the right to buy one share at an exercise price of 50. The options can only be exercised one day after they have vested. The options vest if the employees concerned remain in service for three years from the grant date. The entity recognises the share options granted on a fair value basis and does not choose the alternative permitted by DAS 275 to recognise options granted to employees on an intrinsic value basis.

The fair value of the share on 1 January of year 1 is 50. On subsequent reporting dates, the fair value is as follows: 45, 55 and 65. The fair value of the option at the moment of grant is 5. This fair value should be taken as the starting point for the straight-line allocation to the vesting period and is no longer adjusted according to the change in share value. This is typical of the so-called 'grant date model' that is the basis for the recognition of equity-settled transactions in DAS 275.

The entity has the following expectations of the percentage of employees that will remain employed for the full three years:

- end of year 1: 80%; and
- end of year 2: 85%.

At the end of year 3, 75% of employees concerned are found to be still employed.

Based on the data included above, the following measurements can be derived:

	Share price	Intrinsic value option	Time value option	Fair value option
1 January of year 1	50	0	5	5
31 December of year 1	45	0	3	3
31 December of year 2	55	5	1	6
31 December of year 3	65	15	0	15

The fair value and time value of the option can be determined using an option pricing model. In this example, the time value is notionally determined.

The recognition can be summarised as follows:

	Year	Expense in P&L	Movement in equity excl. profit or loss	Profit or loss	Movement in equity incl. profit or loss
(= 80% x 200 x 100 x 5 x 1/3)	1	26,667	26,667	(26,667)	0
(= 85 x 200 x 100 + 5 x 2/3 - 26,667)	2	30,000	30,000	(30,000)	0
(= 75% x 200 x 100 x 5 x 3/3 - 56,667)	3	18,333	18,333	(18,333)	0
	Total	75,000	75,000	(75,000)	0

Explanation on scenario 1

Recognition in year 1 is as follows:

Employee benefits expense (= 80% x 200 x 100 x 5 x 1/3)	26,667	
Equity		26,667

The calculation takes into account the estimate of the number of employees expected to remain employed for the full three years, as well as the straight-line allocation of expenses over the vesting period based on the fair value of the option on grant date (1 January of year 1).

Recognition in year 2 is as follows:

Employee benefits expense (= 85% x 200 x 100 x 5 x 2/3 – 26,667)	30,000	
Equity		30,000

The costs in year 2 were determined by first determining the cumulative expense (= 56,667) and then deducting from this the expense already recognised in year 1 (= 26,667).

Recognition in year 3 is as follows:

Employee benefits expense (= 75% x 200 x 100 x 5 x 3/3 - 56,667)	18,333	
Equity		18,333

The costs in year 3 were determined by first determining the cumulative expense (= 75,000) and then deducting from this the cumulative expense recognised at the end of year 2 (= 56,667).

Alternative change in share value

If at 31 December of year 3 the fair value of the share is 45 and the options therefore expire being worthless, the following valuations of the options can be derived:

	Share price	Intrinsic value option	Time value option	Fair value option
1 January of year 1	50	0	5	5
31 December of year 1	45	0	3	3
31 December of year 2	55	5	1	6
31 December of year 3	45	0	0	0

The recognition can be summarised as follows:

	Year	Expense in P&L	Movement in equity excl. profit or loss	Profit or loss	Movement in equity incl. profit or loss
(= 80% x 200 x 100 x 5 x 1/3)	1	26,667	26,667	(26,667)	0
(= 85 x 200 x 100 + 5 x 2/3 - 26,667)	2	30,000	30,000	(30,000)	0
(= 75% x 200 x 100 x 5 x 3/3 - 56,667)	3	18,333	18,333	(18,333)	0
	Total	75,000	75,000	(75,000)	0

The fact that the share options expire being worthless has no effect on the recognition under this scenario, as the recognition is based on the fair value on the grant date. The change in the fair value of the share no longer affects this.

Annex 1 to this chapter compares the fair value recognition included above with intrinsic value recognition.

Example: Impact of performance-based conditions on cash-settled transactions

An entity grants 100 share options to 200 employees on 1 January of year 1. Each share option gives the right to receive the difference between the exercise price of 50 and the price of one share. As a result, this share-based payment is classified as cash-settled. Share options can only be exercised one day after they have vested. The options vest if the employees concerned remain in service for three years from the grant date.

The fair value of the share on 1 January of year 1 is 50. On subsequent reporting dates, the fair value is as follows: 45, 55 and 65.

The entity has the following expectations of the percentage of employees that will remain employed for the full three years:

- end of year 1: 80%; and
- end of year 2: 85%.

At the end of year 3, 75% of employees concerned are found to be still employed.

Based on the data included above, the following measurements can be derived:

	Share price	Intrinsic value option	Time value option	Fair value option
1 January of year 1	50	0	5	5
31 December of year 1	45	0	3	3
31 December of year 2	55	5	1	6
31 December of year 3	65	15	0	15

The fair value and time value of the option can be determined using an option pricing model. In this example, the time value is notional.

The recognition can be summarised as follows:

	Year	Expense in P&L	Movement in liability	Profit or loss	Movement in equity incl. profit or loss
(= 80% x 200 x 100 x 3 x 1/3)	1	16,000	16,000	16,000	16,000
(= 85% x 200 x 100 x 6 x 2/3 - 16,000)	2	52,000	52,000	52,000	52,000
(= 75% x 200 x 100 x 15 x 3/3 - 68,000)	3	157,000	157,000	(157,000)	(157,000)
	Total	225,000	225,000	(225,000)	(225,000)

When settlement is in cash and measurement at fair value, recognition on each reporting date is based on the fair value of the liability at that time.

Annex 1 to this chapter compares the fair value recognition included above with intrinsic value recognition.

Impact of price-related conditions
With share-based payments, the entity should not take into account price-related conditions for allocation to the period in which the services are received. For example, a price-related condition is that the vesting of the share granted is conditional on a target value of the share. This is already taken into account when determining the value of the share-based payment (DAS 275.307). See paragraph 28.11.

Taxes
If an entity bears the wage tax (or similar tax) payable by employees on the share-based payment, this expense should be recognised as part of employee benefits. This should be recognised in accordance with the provisions for a cash-settled share-based payment (DAS 275.315).

28.8 Modifications to share-based payments provided to employees

28.8.1 Introduction

An entity may change the conditions under which share-based payments are granted. An entity should recognise the effects of such modifications if those modifications cause the total fair value of the share-based payment to increase at the time of the modification (DAS 275.308). Even if those modifications are otherwise advantageous to employees, an entity should account for their effects. An entity can change the conditions by, for example, reducing the exercise price of options granted to employees, thereby increasing the value of those options at that time.

28.8.2 Modification results in an increase in the fair value of the share option

An entity recognises the increase in fair value resulting from a modification in the determination of the amount recognised for services received as consideration for share options granted. The incremental fair value granted is the difference between the fair value of the modified share option and that of the original share option. Both are estimated on the modification date. The modification can take place during the vesting period. In that case, the incremental fair value granted is recognised in the determination of the amount recognised for services received during the period from the modification date to the date the modified share option vests. This is in addition to the amount based on the fair value on the grant date of the original share options.

The modification can also take place after the vesting date. In this case, the incremental fair value granted is recognised immediately. Along with the modification, a new vesting condition can also be agreed. For example, that the employee must complete an additional number of years of service before becoming unconditionally entitled to those modified share options. In this situation, the incremental fair value is allocated to this new vesting period.
Modification leads to an increase in the number of share options granted.

A modification may also lead to an increase in the number of share options granted. The modification can take place during the vesting period. In that case, the fair value of the additional share options granted is recognised during the period from the modification date to the date the additional share options vest. This is in addition to the amount based on the fair value of the share options originally granted. The recognition is similar to the recognition of a modification that results in an increase in the fair value of the share option.

28.8.3 Vesting conditions are adjusted in a manner that is beneficial to the employee

An entity can also adjust the vesting conditions in a way that is beneficial to the employee. For example, by reducing the vesting period or by changing or dropping a performance condition (not being market-related). In that case, the entity should take these changes into account when applying the true-up method (in accordance with the provisions of DAS 275.3).

28.8.4 Modification does not benefit the employee

An entity may make a modification that reduces the total fair value of the share options or is otherwise not beneficial. In that case, the entity must nevertheless continue to recognise the allocation of expenses as if that modification had not occurred. The recognition is different if there is a cancellation. See paragraph 28.9 for the recognition of cancellations.

Example: Modifications not beneficial to the employee

If, as a result of a modification, the fair value – determined immediately before and after the modification – of share options granted decreases, an entity does not take into account that decrease in fair value. The entity should also recognise the amount included for services received as consideration for share options (determined at the grant date at the fair value of the share options granted).

If, as a result of the modification, the number of share options granted to an employee decreases, an entity accounts for that decrease as a cancellation of that portion of the grant. See paragraph 28.9 for the recognition of cancellations. If an entity amends the vesting conditions in a way that is not beneficial to the employee, for example by extending the vesting period or by changing or adding a performance condition (that is not market-related), the entity does not take into account the changed vesting conditions.

28.8.5 Modification leads to change of settlement

DAS 275 deals with modifications of equity-settled transactions. This includes a change that results in a change in settlement. An example is the addition of a cash alternative to an originally equity-settled transaction.

28.8.5.1 Addition of cash alternative

An entity may have provided equity-settled share-based payments to employees. During the vesting period, the entity decides to change the conditions of these options. Employees will also have the option of settlement in cash. A liability must be recognised from the date of this addition because employees may require the entity to settle in cash (DAS 275.301/206). However, if the vesting period remains unchanged, the straight-line allocation of the employee benefits expense over this period will still need to remain based on the fair value of the equity instruments granted on the grant date (DAS 275.0/304). Finally, this constitutes a modification and the incremental benefit to the employee on the modification date should be determined and recognised over the remaining period. The following example illustrates this. This example is partly based on IFRS 2 IG Example 9.

Example: Addition of cash alternative

At the beginning of year 1, an entity issues 10,000 shares to a director. The grant vests when the director works for the entity for another three years (service condition). At the time of grant, the fair value of a share is 33. At the end of year 2, the fair value of a share has fallen to 25 per share. At that point, the entity decides to modify the conditions of the share-based payment (modification date). The director will have the right to choose, on the vesting date, between receiving 10,000 shares or a cash amount of 300,000 at the time of vesting. It is further given that the fair value of the share at the time of vesting is 22.

An entity recognises the services received based on the fair value of the shares granted on grant date on a straight-line basis over the three-year vesting period (DAS 275.304). In other words, unless the director fails to comply with the service condition (i.e. leaves early), a employees benefit expense of 110,000 (= 10,000 x 33 x 1/3) will be recorded each year.

In addition, adding the cash alternative creates a liability at the end of year 2. In accordance with the DAS provisions on settlement alternatives, the entity recognises a liability based on the fair value of the liability (DAS 271.301/206) taking into account the straight-line allocation over the vesting period (DAS 271.304). On each subsequent reporting date and at the time of settlement, the entity remeasures the liability at fair value. Changes in value are recognised through profit or loss.

And finally, the incremental benefit should be determined at modification date by comparing the fair value of the original plan with the fair value after modification. Again, considering a straight-line allocation over the vesting period, i.e. taking into account the ratio between the services received until the modification date (two years) and the remaining period (one year) until vesting. On the modification date, therefore, the company has received 2/3 of the director's services and he still has to provide a year's worth of services.

Year 1

The entity accounts for the employee benefits expense resulting from the share-based payment granted at the beginning of year 1 as follows:

Employee benefits expense	110,000	
Equity (= 10,000 x 33 x 1/3)		110,000

Year 2

The entity recognises the employee benefits expense resulting from the share-based payment granted at the beginning of year 1 (DAS 275.304) as follows:

Employee benefits expense	110,000	
Equity (= 10,000 x 33 x 2/3 – 110,000)		110,000

The addition of the cash alternative results in the recording of a liability charged to equity that is recognised *pro rata* to the passage of the vesting period (DAS 275.301/205/206):

Equity	200,000	
Liability (= 300,000 x 2/3)		200,000

The incremental benefit on the modification date is calculated as follows. The fair value of the original plan on the modification date is 250,000 (10,000 shares x 25). The fair value of the modified plan in which, effectively, a share price of 30 is guaranteed and the director can additionally benefit from share price increases (call option element) is set at 310,000. Taking into account the services already received, the incremental benefit is equal to: 2/3 x (310,000-250,000) = 40,000. This incremental benefit is allocated as an employee benefits expense to year 3 (the vesting period from the modification date).

Year 3

The entity recognises the employee benefits expense resulting from the share-based payment granted at the beginning of year 1 (DAS 275.304) as well as the incremental benefit. The credit entry consists of the increase in the liability. The difference is recognised directly in equity. See journal entries below:

Employee benefits expense (= 110,000 + 40,000 incremental benefit)	150,000	
Liability (= 300,000 x 1/3)		100,000
Equity (balance)		50,000

At the end of Year 3, the liability is paid at the request of the director:

Liability	300,000	
Bank		300,000

Thus, for the entire period, 370,000 of employee benefits expense was recognised based on the allocation of the fair value of the equity instruments determined on the grant date (10,000 shares x 33) plus the incremental benefit on the modification date. Furthermore, a liability has been formed from the settlement alternative based on the settlement alternative of 300,000 cash. The difference has been recognised in equity.

28.8.5.2 Modification from cash-settled to equity-settled

DAS 275 does not contain specific guidance on how to recognise a change from cash-settled to equity-settled. IFRS 2 does contain specific provisions for such a modification. Given the similar principles under IFRS and NL GAAP in this area, it is acceptable under DAS 110.110 to apply this method of recognition under NL GAAP. At the time of change from cash-settled to equity-settled, under IFRS 2, the recognition is as follows:

a. the equity-settled share-based payment is measured by reference to its fair value on the modification date. The equity-settled share-based payment is recognised in equity on the modification date to the extent that goods or services have been received;
b. the original liability is derecognised; and
c. any difference between a and b is recognised immediately in the profit and loss account.

Example: Modification from cash-settled to equity-settled

At the beginning of year 1, an entity issues 100 share appreciation rights (SARs) to a director. The exercise price is 15 per SAR. The grant vests when the director works for the entity for four years (service condition). SARs can only be settled in cash (cash-settled). At the time of grant, the fair value of a SAR is 5.

At the end of year 2, the fair value of a SAR is 6. At that point, the entity expects all SARs to vest. The entity has therefore cumulatively recognised the following during year 1 and year 2:

Employee benefits expense (= 100 x 6 x 2/4)	300	
Liability		300

At the beginning of year 3, the entity changes the conditions of the share-based payment. It is no longer possible to settle the SARs. Instead, the director will receive 100 share options. The fair value of a share option granted is 7 on the modification date. The total fair value of the 100 share options is 700. The share options vest if the director remains employed for another two years. Therefore, the original vesting period does not change.

As a result of this modification, a liability no longer exists. The entity must therefore derecognise the liability. This liability was in fact settled by the issue of the share options. The director now has the right to acquire shares instead of cash at the time of vesting. The value of the share options on the modification date is 700. The extent to which the entity has received the director's services is 50% (= 2 years / 4 years). As a result, an amount equal to 350 (= 50% of 700) is recognised in equity on the modification date. The difference between this amount and the amount of the liability derecognised on the balance sheet is 50. That difference is immediately recognised in the profit and loss account. The recognition is as follows:

Liability	300	
Employee benefits expense	50	
Equity		350

The modification results in employee benefits expense attributable to year 3 and year 4 being based on the fair value of the share options at the time of modification (7 per share option). Under the assumption that all share options will vest, the entry in both year 3 and year 4 is as follows:

Employee benefits expense (= 100 x 7 x ¼)	175	
Equity		175

28.8.5.3 Modification from equity-settled to cash-settled

A change from equity-settled to cash-settled refers to a modification of an equity-settled transaction. DAS 275 does not contain specific guidance on such modifications. IFRS 2 also has no specific provisions. The examples below reflect a recognition in line with the provisions of DAS 275.

Example: Modification leads to same fair value as original share option

At the beginning of year 1, an entity grants 100 share options to a director. The exercise price is 15 per share option. The grant vests when the director works for the entity for another four years (service condition). The share options can only be settled through the issue of shares (equity-settled). At the time of grant, the fair value of a share option is 5.

The entity expects all options to vest. The entity has therefore cumulatively recognised the following during year 1 and year 2:

Employee benefits expense (= 100 x 5 x 2/4)	250	
Equity		250

On 1 January of year 3, the entity changes the conditions of the share-based payment. It is no longer possible to settle share options in shares. Instead, settlement must be in cash. Upon settlement, the entity pays the intrinsic value of the share options to the director. On the modification date, the fair value is 4 per share option.

As a result of this modification, a liability arises. The entity must therefore include a liability. The obligation to deliver a fixed number of equity instruments was effectively settled by issuing the liability. The director now has the right to obtain cash instead of equity instruments at the time of vesting. The fair value of share options at the time of modification is 400 (= 100 x 4).

The fair value of both alternatives on the modification date is 400. As there is no difference between the fair value of the originally equity-settled share option and the modified share option, the entity recognises a liability taking into account the degree of vesting (2 years out of the 4-year vesting period). The contra entry is a decrease in equity.

Equity	200	
Liability (= 400 x 2/4)		200

The liability is settled at the end of year 4 for 450. The increase in the fair value of the liability is recognised in profit or loss over the remaining vesting period (year 3 and year 4):

Employee benefits expense	250	
Liability (= 450 - 200)		250

Example: Modification results in higher fair value than original share option

At the beginning of year 1, an entity grants 100 share options to a director. The exercise price is 15 per share option. The grant vests when the director works for the entity for another four years (service condition). The share options can only be settled through the issue of shares (equity-settled). At the time of grant, the fair value of a share option is 5.

The entity expects all options to vest. The entity has therefore cumulatively recognised the following during year 1 and year 2:

Employee benefits expense (= 100 x 5 x 2/4)	250	
Equity		250

On 1 January of year 3, the entity changes the conditions of the share-based payment. It is no longer possible to settle share options in shares. Instead, settlement must be in cash. Upon settlement, the entity pays the intrinsic value of the share options to the director. On the modification date, the fair value is 4 per share option (before modification). After the modification, the fair value of the share option is 4.20.

As a result of this modification, a liability arises. The entity must therefore include a liability. The obligation to deliver a fixed number of equity instruments was effectively settled by issuing the liability. The director now has the right to obtain cash instead of equity instruments at the time of vesting. The fair value of the share options before the modification is 400 (= 100 x 4) on the modification date. After the modification, the fair value is 420 (= 100 x 4.20).

An increase in fair value due to a modification is recognised by an entity in determining the amount recognised for services received as consideration for share options granted. The incremental fair value granted is the difference between the fair value of the modified share option and that of the original share option. Both are estimated on the modification date. The modification can take place during the vesting period. In this case, the incremental fair value granted is recognised taking into account the extent to which the vesting period has already expired. In this example, it is 50 per cent (two out of four years).

Thus, on 1 January of year 3, the entity recognises a liability in the amount of 210 (= 420 x 2/4). This liability compares the entity with the fair value of the original share option taking into account the degree of vesting in the amount of 200 (= 400 x 2/4). The difference of 10 is immediately recognised as an employee benefits expense expense. The entity recognises this as follows:

Employee benefits expense	10	
Equity	200	
Liability (= 420 x 2/4)		210

The liability is settled at the end of year 4 for 450. The increase in the fair value of the liability is recognised in profit or loss over the remaining vesting period (year 3 and year 4):

Employee benefits expense	240	
Liability (= 450 - 210)		240

Example: Modification results in lower fair value than original share option

At the beginning of year 1, an entity grants 100 share options to a director. The exercise price is 15 per share option. The grant vests when the director works for the entity for another four years (service condition). The share options can only be settled through the issue of shares (equity-settled). At the time of grant, the fair value of a share option is 5.

The entity expects all options to vest. The entity has therefore cumulatively recognised the following during year 1 and year 2:

Staff expenses (= 100 x 5 x 2/4)	250	
Equity		250

On 1 January of year 3, the entity changes the conditions of the share-based payment. It is no longer possible to settle share options in shares. Instead, settlement must be in cash. Upon settlement, the entity pays the intrinsic value of the share options to the director. On the modification date, the fair value is 4 per share option (before modification). After the modification, the fair value of the share option is 3.80.

As a result of this modification, a liability arises. The entity must therefore include a liability. The obligation to deliver a fixed number of equity instruments was effectively settled by issuing the liability. The director now has the right to obtain cash instead of equity instruments at the time of vesting. The fair value of the share options before the modification is 400 (= 100 x 4) on the modification date. After the modification, the fair value is 380 (= 100 x 3.80).

On 1 January of year 3, the entity recognises a liability in the amount of 190 (= 380 x 2/4). This liability compares the entity with the fair value of the original share option taking into account the degree of vesting in the amount of 200 (= 400 x 2/4). As the fair value of the modified share option is lower than the fair value of the original share option, the entire liability is recognised against equity. No additional employee benefits expense is recorded. The entity recognises this as follows:

Equity	190	
Liability (= 380 x 2/4)		190

The liability is settled at the end of year 4 for 450. The increase in the fair value of the liability is recognised in profit or loss over the remaining vesting period (year 3 and year 4):

Employee benefits expense	260	
Liability (= 450 - 190)		260

28.9 Cancellation and early settlement of share-based payments provided to employees

28.9.1 General

An entity may cancel or early settle share options during the vesting period. The option scheme is then effectively bought out. This is not related to the failure to meet vesting conditions. In case of cancellation or early settlement of share options during the vesting period, the following provisions apply (DAS 275.310 and 311):.

- the cancellation or settlement by the entity is recognised as an acceleration of the commitment becoming unconditional, and therefore the amount that would otherwise have been recognised in relation to services received during the remainder of the vesting period is immediately recognised;
- any payment to the employee on cancellation or settlement is:
    - in the case of an equity-settled share-based payment, charged to equity as a repurchase of equity instruments. To the extent the payment exceeds the fair value of the share options granted, determined on the repurchase date, any surplus is recognised as an expense.
    - in the case of a cash-settled share-based payment, charged to the obligation recorded up to that point. Any surplus payment will be recognised as an expense.
- if new share-based payments are granted to the employee and the entity designates those new share-based payments as a replacement for the cancelled share-based payments on the date of grant, the replacement share-based payments will be recognised in the same way as a modification of the original share-based payments granted (as described in paragraph 28.8). However, see also section 28.9.2.

At the end of the example in Appendix 1 of this chapter, the processing of cancellation or early settlement of share options provided to the employee is illustrated.

28.9.2 Grant of new share options to replace cancelled options

In the last bullet point of the previous paragraph, it is indicated that new share options granted to the employee that are designated as a replacement for cancelled share options are recognised in the same way as a modification of the share options originally granted. An entity may also consider that the newly granted share options are not a replacement for the cancelled share options. In that case, the entity recognises these new share options as a new grant of share options. Crucially, therefore, the question is whether or not newly granted share options should qualify as replacement. DAS 275 has no specific provisions to answer this question. The same is true of IFRS 2. Based on the specific facts and circumstances, an entity will have to determine what is involved.

However, despite the absence of specific provisions on this distinction, an entity does not have a free choice. Based on the specific facts and circumstances, it should be determined what is involved. The following indicators can be used to assess the replacement of cancelled share options:

- the new share options are granted to the same participants as the cancelled options;
- the new share options have a fair value at the time of issue that is more or less equivalent to the fair value of the cancelled options at the time of the original grant date (indication that there is no replacement, but fair value adjustment) or at the time of cancellation (indication of replacement);
- the grant of new share options and the cancellation of share options are part of the same contract; and
- the cancellation of share options cannot be understood in economic terms without the grant of new share options.

Example: Replacement of share options

Entity A grants options in year 1 to its employees. The options have a four-year vesting period. These options had an exercise price in the amount of 10 per share. The fair value of the options granted was determined at 100,000 on the grant date. In year 3, A cancels these options and issues new options with an exercise price of 3 per share. The fair value of these options on the grant date is 75,000. If the issue of the new options is a replacement, the recognition is as follows. A immediately recognises the remaining part of the originally granted fair value of 100,000 as an expense. The fair value of the new options is recognised as an expense over the vesting period of these new options. As a result, a total of 175,000 (= 100,000 + 75,000) is ultimately recognised as an expense in relation to these options. A relatively large proportion of these expenses are allocated to earlier periods.

However, the recognition is different if the newly provided options are a replacement for the cancelled options. In that case, A recognises the transaction as a modification. A continues the allocation of the remaining part of the originally allocated fair value of 100,000 over the original vesting period. In addition, A recognises the incremental fair value granted in the determination of the amount included for services received during the period. This happens from the modification date until the date the modified share options vest. Assume the original options had a fair value of 20,000 on the cancellation date. The incremental fair value granted is then 55,000 (= 75,000 - 20,000). This incremental fair value is charged to profit or loss over the remaining vesting period. As a result, a total of 155,000 (= 100,000 + 55,000) is ultimately recognised as an expense in relation to these options.

This example illustrates that considering new share options as replacements for cancelled options can be attractive. Based on the specific facts and circumstances, A must determine what is involved.

28.10 Repurchase of vested shares or share options

An entity can repurchase shares or share options that have vested. The amount paid may be equal to the fair value of the share or share options respectively on the repurchase date. The amount may also be lower. In those situations, the amount paid is deducted directly from equity. The amount paid may also be higher than the fair value. In that case, the entity deducts the part of the payment equal to the fair value directly from equity. The other part of the payment (surplus above fair value) is recognised by the entity as an expense in the profit and loss account (DAS 275.312).

28.11 Share-based payments within a group

28.11.1 Introduction

DAS 275 does not need to be applied for the recognition of share-based payments within a group. These are share-based payments initiated or settled by a person or company that is not part of the consolidation scope of the entity (DAS 275.103a). For example, if a holding entity has granted a share option scheme to employees of an operating entity and that scheme is also settled by that holding entity, the operating entity does not have to recognise the scheme in its financial statements under DAS 275. The operating entity may also choose to do so. The operating entity must make a choice in this and apply it consistently.

If a holding company recharges costs associated with share-based payments to the operating company, it may be that this recharge for the operating company constitutes a share-based payment that falls within the scope of DAS 275 and should therefore be recognised as such.

Example: A share option scheme within a group

A holding company grants equity-settled share options to employees of an operating company, which are settled with the employees by the holding company. The operating company chooses to apply the exemption of DAS 275. When the options vest, the holding company recharges the fair value of the vested options to the operating company.

The recharge by the holding company constitutes a share-based payment for the operating company according to the definitions of DAS 271.0, which is a transaction where the operating company receives services for which a payment is made based on the value of the shares of an entity that belongs to the same group as the entity (in this case, the holding company at the head of the group). More specifically, it involves a share option scheme for employees, namely an arrangement under which employees of an entity (the operating company) are rewarded by giving them the right to acquire shares of an entity that belongs to the same group (that of the holding company) (DAS 271.0). For the operating company, the amount of the recharge is a cash-settled share-based payment. This must be processed as described in paragraph 28.7. This means that the operating company must allocate and account for the costs and liability during the vesting period.

In certain other situations, we believe that if the operating entity itself receives the services of the employees and makes use of the exemption of DAS 275, this may constitute an employee benefit that is in scope of DAS 271 'Employee benefits'. We would point in particular to employee benefits given in the form of bonus payments by the operating entity (subject to payroll tax) where it has been agreed that the holding entity will fully reimburse the operating entity.

Example: A share appreciation right within a group

A holding entity grants employees of an operating entity a bonus payment that is paid out when the operating entity's shares are successfully sold to a new owner or if a successful listing of the operating entity's shares on an EU-regulated stock exchange takes place ('initial public offering'). The amount of the bonus thereby depends on the amount of the price per share sold or listed on the stock exchange. This makes it a cash-settled share-based payment. Because settlement is based on the level of the price per share, it is also referred to as a share appreciation right (SAR). Although the SAR contract was initiated by the holding entity, payment is made by the operating entity for practical reasons. In the operating entity, payroll administration takes place and payroll taxes are remitted to the tax authorities. The operating entity obtains the necessary cash required for settlement directly from the holding entity.

Under DAS 275.103a, the operating entity can choose not to apply DAS 275 'Share-based payments'. In our view, however, these are essentially employee benefits during employment payable by the operating entity in accordance with applicable terms of employment (DAS 271.201). This means that if DAS 275 is not applied by the operating entity, DAS 271 'Employee benefits' must be applied and the operating entity must recognise this remuneration as a bonus payment. The fact that the operating entity is fully remunerated by the holding entity does not change this. After all, that could apply to any profit-sharing or bonus payment. Application of DAS 271 may well result in a different cost pattern during the vesting period than under DAS 275. Under DAS 271, the bonus payment must be recognised when the liability arises and can be reliably estimated (DAS 271.209, see paragraph 18.2). Under DAS 275, costs are allocated to the vesting period (see paragraph 28.6.3 and the remainder of this paragraph).

In the application of both DAS 275 and DAS 271, the operating entity will also have to recognise the holding entity's promise to reimburse the payment of remuneration, against the recognition of the expense arising from the payment. Here, the expense under the SAR scheme will be recognised as part of employee benefits expense. In our opinion, the remuneration of the holding entity should not be netted against this expense as the netting requirements are not met, but will have to be presented separately in either the profit and loss account or as an informal capital contribution to equity.

This paragraph further discusses the method of recognition if an entity within a group voluntarily elects to recognise share-based payments in its financial statements. In that case, under DAS 110.110, we consider the provisions of IFRS 2 'Share-based Payment' to be applicable. The remainder of this paragraph explains these provisions in more detail.

28.11.2 Recognition by group entity receiving the goods or services

Entities within a group can make share-based payments. In its own financial statements, the group entity that receives the goods or services recognises an expense. The group entity determines the amount of the expense in accordance with the provisions for equity-settled transactions or in accordance with the provisions for cash-settled transactions. A group entity determines the following based on (IFRS 2.43A):

- the nature of the share-based payments granted; and
- the group entity's rights and obligations under these share-based payments.

The IASB emphasises that the amount recognised by a group entity may differ from the amount recognised in the group's consolidated financial statements or from the amount recognised by another entity within the group that settles the transaction (IFRS 2.43A).

The group entity receiving the goods or services recognises the share-based payment as an equity-settled transaction in the following two situations (IFRS 2.43B):

- the remuneration granted is the equity instruments of the group entity itself; or

- the group entity has no obligation to settle the share-based payment.

In all other cases, the group entity receiving the goods or services recognises it as a cash-settled transaction (IFRS 2.43B).

28.11.3 Recognition by group entity settling transaction while another group entity receives the goods or services

A group entity can settle a share-based payment while another group entity receives the goods or services. In that case, the group entity settling the transaction recognises it as an equity-settled transaction if the settlement takes place in its own equity instruments. In all other cases, this group entity recognises the transaction as a cash-settled transaction (IFRS 2.43C).

28.11.4 Intercompany settlement between group entities

In the case of share-based payments within a group the group entities can agree on how to settle costs between themselves. For example, by payment of an amount by the group entity receiving services from employees to the group entity delivering the shares to those employees. In such cases, the group entity receiving the goods or services always recognises the associated expense. Independently of intercompany settlement arrangements between group entities (IFRS 2.43D).

Example: Share-based payments within a group (1)

Parent entity grants rights to its own shares to employees of subsidiary. The subsidiary has no obligation to deliver the parent entity's shares to its employees. IFRS 2.43B provides that in this situation, the subsidiary recognises the services received from the employees concerned as equity-settled. To this end, the subsidiary recognises in its own financial statements a staff expense on the one hand and a direct increase in equity on the other. This increase in equity relates to a capital contribution by the parent entity. The subsidiary recognises the following entry in its financial statements:

Employee benefits expense	X	
Equity		X

The parent entity has an obligation to settle the share-based payment with the subsidiary's employees by delivering its own shares. In accordance with IFRS 2.43C, the parent entity recognises its liability in its company-only financial statements in accordance with the provisions applicable to equity-settled transactions. The parent entity recognises the following entry in its company-only financial statements:

Interest in subsidiary	X	
Equity		X

Example: Share-based payments within a group (2)

Subsidiary grants its own employees rights to parent entity shares. In this case, the subsidiary recognises the share-based payment as cash-settled. While the employee benefits granted are not equity instruments of the subsidiary itself, the subsidiary has an obligation to settle the share-based payment with the employees. IFRS 2.43B provides that in that case, the subsidiary recognises it as cash-settled. This is required irrespective of how the subsidiary acquires the shares of the parent entity to settle its obligation to the employees. The subsidiary recognises the following entry in its financial statements:

Employee benefits expense	X	
Liability		X

In that case, the parent entity does not recognise any of this share-based payment in its company-only financial statements.

Example: Share-based payments within a group (3)

Parent entity provides cash-settled share-based payments to employees of subsidiary. The cash-settled payments provided may be based on the price of shares of the subsidiary itself or on the price of shares of the parent entity. The subsidiary has no obligation to settle share-based payments with its employees. The subsidiary therefore recognises the transaction in its financial statements as equity-settled. This only takes into account changes due to non-market conditions not being met. The subsidiary recognises the following entry in its financial statements:

Employee benefits expense	X	
Equity		X

The parent entity has an obligation to settle the share-based payment by payment to the subsidiary's employees concerned. In accordance with IFRS 2.43C, the parent entity recognises its obligation in its company-only financial statements in accordance with the provisions applicable to cash-settled transactions. The parent entity recognises the following entry in its company-only financial statements:

Interest in subsidiary	X	
Liability		X

In the consolidated financial statements of the parent entity, the above transaction is obviously also recognised as cash-settled.

28.11.5 Transfers of employees between group entities

Within a group, there may also be share-based payment arrangements affecting multiple entities within a group. For example, a parent entity may grant employees of all its subsidiaries rights to its own shares on the condition that the employees continue to work for the group for a certain period of time. An employee may transfer to another subsidiary during this vesting period. In that case, the question is how should this be handled in the financial statements of both subsidiaries? If the subsidiaries have no obligation to settle the share-based payment with the employees, they recognise the transaction as equity-settled. Each subsidiary recognises the received services performed by the employee based on the fair value of the equity instruments on the grant date and the portion of the vesting period that such employee works for the subsidiaries. This refers to the fair value at the date the parent entity granted these rights to the employee.

If the subsidiaries do have an obligation to settle the share-based payment with the employees, they recognise the transaction as cash-settled. Each subsidiary recognises the received services based on the fair value of the rights granted on the grant date. Each subsidiary determines the fair value of the obligation on each reporting date and on the settlement date until settlement. Here, a subsidiary takes into account the portion that an employee worked for the subsidiary during the vesting period.

Any changes in fair value are recognised in the profit and loss account for the vesting period. The aforementioned employee may leave the group before the end of the vesting period. As a result, the vesting condition requiring the employee to continue working for the group for the agreed period is not met by this employee. As a result, each subsidiary for which this employee worked during the vesting period adjusts the previously recorded staff expenses. Ultimately, the cumulative amount of the employee benefits expense recognised by relevant subsidiaries is based on the share-based payment that vests. On a cumulative basis, no employee benefits expense is recognised by either subsidiary if an employee leaves the group before the end of the vesting period.

28.12 Determining fair value

28.12.1 Introduction

In determining the fair value of share-based payments on the measurement date, consideration should be given to price-related conditions, such as a target share value, on which the vesting of the share-based payment depends. Performance conditions should not be taken into account when determining fair value (DAS 275.404).

When to take into account price-related and performance-related conditions, respectively, is shown in the table below:

	Price-related conditions	Performance-related conditions
In determining fair value of share-based payments at measurement date, consider:	Yes	No
In determining allocation to periods of share-based payments, consider:	No	Yes

The fair value of a share-based payment should be determined based on the market price on the measurement date, if available. This should take into account the price-related conditions under which those equity instruments are granted (DAS 275.402).

If no market price is available, the fair value of a share-based payment should be determined using measurement techniques. This estimates what the price of, say, the equity instrument would have been on the measurement date in the case of a transaction between knowledgeable, willing parties who are independent. If those independent parties have agreed on fair value in the context of the transaction, then this is used (DAS 275.403).

The measurement technique used should be in line with generally accepted measurement methods for valuing financial instruments (see Chapter 21). The application of the measurement technique should take into account all factors and assumptions that knowledgeable, willing parties to the transaction should consider (DAS 275.403). The Dutch Accounting Standards Board explains that any internal measurement model applied by an entity for valuing its own shares can be used to determine the fair value of share-based payments. The remainder of this paragraph includes additional guidance from IFRS 2. This guidance is applicable under DAS 110.110 for determining the fair value of share-based payments under NL GAAP.

28.12.2 The measurement date and the grant date

The measurement date is the date on which the fair value of equity instruments granted under share-based payments is determined. In the case of transactions with employees and others providing similar services, the measurement date is the same as the grant date (grant date model). In case of transactions with parties other than employees (and persons providing similar services), the measurement date is the same as the date on which an entity acquires the goods or the other contracting party provides the services.

The grant date is the date on which an entity and another party (e.g. an employee) agree on a share-based payment contract. This is when the entity and the other contracting party both accept the terms of the contract. On the grant date, the entity grants the other contracting party the right to cash, other assets, or equity instruments of the entity. If vesting conditions are agreed upon, the right only arises on fulfilment of those conditions. A contract may be subject to an approval process (by shareholders, for example). In that case, grant date is the date on which approval is obtained.

28.12.3 Value based on fair value of goods and services

If fair value is determined based on the value of the goods and/or services received, any discounts, etc. must be taken into account. The value of the goods and/or services received need not equal the value of the equity instruments issued. In that case, the difference may be due to volume discounts. If this is indeed the case, these discounts should be deducted from the amount recognised.

28.12.4 Fair value of shares

Certain share-based payments must be valued based on the fair value of the shares granted. A company should determine the fair value of shares on the measurement date based on market prices, if available. This should take into account the conditions under which those shares were granted (IFRS 2.B2). If there are no market prices available, the company estimates the fair value of the shares granted using a measurement technique. This determines fair value. This is the price of those shares on the measurement date as it would have been in the event of a transaction between knowledgeable, willing parties who are independent. The measurement technique should be consistent with generally accepted measurement methods for valuing financial instruments. The technique should take into account all factors and assumptions that knowledgeable, willing parties to a transaction would consider in setting the price.

With regard to shares granted to employees, the fair value of the shares should be determined at the market price of the company's shares. If the company's shares are not publicly traded, the fair value must be estimated, adjusted to reflect the conditions under which the shares were granted – except for vesting conditions that are not taken into account in determining fair value. For example, if the employee is not entitled to dividend during the vesting period, this factor should be taken into account when determining the fair value of the shares granted. Transfer restrictions may apply in respect of the shares after vesting. In that case, that factor must be taken into account. But only to the extent that the transfer restrictions after vesting affect the price that a knowledgeable, willing market participant would be willing to pay for that share. For example, if the shares are actively traded in a deep and liquid market, transfer restrictions after vesting may have little or no effect on fair value. Transfer restrictions or other restrictions in place during the vesting period are not taken into account when estimating the fair value of the shares granted on the grant date. These restrictions must be taken into account when allocating expenses to the vesting period (in accordance with IFRS 2.19 to 21).

28.12.5 Fair value of share options

Option pricing models (IFRS 2.B4-B10)
In many cases, when share options are granted to employees, there are no market prices available because the options granted are subject to conditions that do not apply to traded options. If no traded options with similar terms exist, the fair value of the options granted should be estimated using an option pricing model.

The company should consider factors that knowledgeable, willing market participants would take into account when choosing the option pricing model to be used. An example is employee options that are often exercised early. These options often have long lives. In addition, they are usually exercisable between the date they vest and the end of the options' lives. These factors should be taken into account when estimating the fair value of options on the grant date.

For many companies, this could preclude the use of the Black-Scholes-Merton model. That model does not take into account the possibility of exercise before the end of the option's life, which may not adequately reflect the consequences of an expected early exercise. Also, this model does not take into account the possibility that expected volatility and other data used in the model may fluctuate over the life of the option. However, the aforementioned factors need not apply to share options with a relatively short contractual maturity or to options to be exercised at short notice after vesting. In those cases, the Black-Scholes-Merton model can produce a value that is almost the same as in a more flexible option pricing model.

Any option pricing model used should consider at least the following factors:

- the exercise price of the options;
- the life of the option;
- the current price of the underlying shares;
- expected share price volatility;
- if applicable, the expected dividend on the shares; and
- the risk-free interest rate for the life of the option.

Other factors that knowledgeable, willing market participants would consider when setting the price should also be taken into account, with the exception of vesting conditions and 'reload' features which, in accordance with IFRS 2.19-22, are not included in the determination of fair value. An example is a share option granted to an employee. This usually cannot be exercised during certain periods. For example, during the vesting period and during periods set by securities regulators. This factor should be taken into account if the option pricing model applied otherwise assumes that the option can be exercised at any time during its life.

However, if a company uses an option pricing model that produces the value of an option that can only be exercised at the end of the option's life, then no adjustment is required for the lack of possibility to exercise it during the vesting period (or other periods during the option's life). After all, the model assumes that the option cannot be exercised during these periods. Another common factor in employee share options is the possibility of early exercise of the option. For example, because the option is not freely transferable or because the employee must exercise all vested options upon termination of the employment contract. The factors that a knowledgeable, willing market participant would not take into account when setting the price of a share option (or other equity instrument) should not be taken into account when estimating the fair value of share options (or other equity instruments) granted. For example, in the case of share options granted to employees, the factors affecting the value of the option from only the employee's perspective are not relevant in estimating the price that would be set by a knowledgeable, willing market participant.

Data used in option pricing models (IFRS 2.B11-15)
A company should not base estimates of volatility, behaviour towards exercise and dividends solely on historical information. The extent to which past experience has a reasonable predictive value should be assessed. Future expectations are generally based on empirical figures. These should be adjusted if the future is reasonably expected to differ from the past. In some circumstances, identifiable factors may show that unadjusted empirical figures have a relatively poor predictive value for future outcomes.

For example, a company may have two distinctly different business activities. If the significantly less risky activity is disposed of, historical volatility is probably not the best information on which to base reasonable expectations for the future. It may also be that historical information is simply not available. A newly listed company, for example, will have little or no historical data to base volatility on.

Expected early exercise (IFRS 2.B16-21)
Employees often exercise options early. There can be a variety of reasons for this. One reason is that employee share options are usually not transferable. Therefore, employees often exercise their share options early. It is the only way to monetise their position. Moreover, employees leaving employment are usually required to exercise any vested options at short notice. Otherwise, the share options will lapse. This factor also ensures that employee share options are often exercised early. Other factors that may cause early exercise are risk aversion and lack of asset diversification.

How the effects of expected early exercise are taken into account depends on the type of option pricing model applied. For example, expected early exercise could be taken into account by incorporating in an option pricing model (e.g. the Black-Scholes-Merton model) an estimate of the expected life of the option (which for an employee share option is the same as the period from the grant date to the date the option is expected to be exercised). Alternatively, expected early exercise could also be taken into account in a binomial or similar option pricing model using the contractual maturity as input data.

The following factors, among others, should be taken into account when estimating the expected early exercise:

- The length of the vesting period. The share option cannot usually be exercised before the end of the vesting period. Hence, in determining the measurement impact of expected early exercise, the options are assumed to vest. The effects of vesting conditions are discussed in IFRS 2.19-21.
- The average length of time during which similar options have been outstanding in the past.
- The price of the underlying shares. Experience may show that employees tend to exercise options when the share price reaches a certain level above the exercise price.
- The employee's level in the organisation. For example, experience might indicate that higher-level employees exercise options later than lower-level employees.
- The expected volatility of the underlying shares. On average, employees are more likely to exercise options on highly volatile shares than options on shares with low volatility.

As noted, the effects of early exercise can be taken into account by using an estimate of the expected life of the option. This fact can be used as input in an option pricing model. When estimating the expected life of share options granted to a group of employees, the company may base that estimate on an appropriate weighted average expected life for the entire group of employees or on appropriate weighted average lives for subgroups of employees within the group.

It is important to divide an option grant into groups of employees with relatively homogeneous behaviour towards exercise. The option value is not a straight-line function of the option's life. The value increases at a decreasing rate the longer the life. For example, other assumptions being equal, a two-year option is worth more than a one-year option, but the two-year option is not worth twice as much. This means that when calculating the estimated option value based on a single weighted average life that is the average of widely varying individual les, there is an overstatement of the total fair value of share options granted. The dividing of the options granted into different groups, with the weighted average life of each group being the average of a relatively narrow range of lives, reduces this overstatement.

Similar considerations apply when applying a binomial or similar model. For example, the experience of a company that grants options to roughly all levels of employees may be that top-level managers hold their options longer that lower-level managers, and that low-level employees tend to exercise their options earlier than any other group. Moreover, employees who are encouraged or required to hold a minimum amount of equity instruments, including options, would, on average, exercise options later than employees to whom this does not apply. In those cases, dividing options based on groups of recipients with relatively homogeneous behaviour towards exercise will result in a more accurate estimate of the total fair value of options granted.

Expected volatility (IFRS 2.B22-25)
Expected volatility is a measure of the amount by which a price is expected to fluctuate over a period of time. The measure of volatility used in the context of option pricing models is the annualised standard deviation of the continuously compounded return on the share over a given period. Volatility is usually expressed on an annual basis for comparability purposes regardless of whether the calculation is based on, for example, price observations on a day, during a week or a month. The return (which can be either positive or negative) on a share over a period indicates how much a shareholder has benefited from dividends and the rise (or fall) in the share price. The following factors, among others, should be taken into account when estimating expected volatility:

- the implied volatility of traded share options on the company's shares, or any other traded instruments of the company with option features (such as convertible debt securities);
- the historical volatility of the share price during the most recent period which generally coincides with the expected life of the option (taking into account the remaining contractual maturity of the option and the effects of expected early exercise);
- the duration of the period during which a company's shares are traded on the stock exchange. A newly listed company might have higher historical volatility than comparable companies that have been listed for longer. Further guidelines are given below for recently listed companies;
- the tendency of volatility to move towards the long-term average, and other factors indicating that expected future volatility could differ from historical volatility. For example, if a company's share price was unusually volatile during an identifiable period due to a failed acquisition or significant restructuring, that period could be disregarded when calculating annualised historical average volatility; and
- appropriate and regular periods for price observations. Price observations should be consistent from period to period. For example, a company could use the closing rate for each week or the highest price in the week, but not the closing rate for some weeks and the highest price for other weeks. Moreover, price observations should be denominated in the same currency as the strike price.

Recently listed companies (IFRS 2.B26)
A company should consider the historical volatility of the share price over the most recent period which is generally equal to the expected life of the option. If a newly listed company has insufficient information on historical volatility, it should nevertheless calculate historical volatility for the longest period for which trading activity has taken place. It could also consider the historical volatility of similar companies after a similar period in their existence. For example, a company listed for one year that grants options with an average expected life of five years could factor in the pattern and level of historical volatility of companies in the same sector over the first six years in which those companies' shares were publicly traded.

Unlisted companies (IFRS 2.27-30)
An unlisted company will not have historical information that can be used in estimating expected volatility. The following are some of the factors that should be taken into account instead. In a number of cases, an unlisted company that regularly issues options or shares to employees (or other parties) may have established an internal market for the shares. In estimating expected volatility, the company can use the volatility of those shares. On the other hand, when estimating expected volatility, the company could use the historical or implied volatility of similar listed companies, for which information on share and option prices is available. This would be the case if the company has based the value of the shares on the share prices of similar listed companies. If the company has not based its share value estimate on the share prices of similar listed companies, and instead has used another valuation method to value its shares, the company could derive an estimate of expected volatility in line with that measurement method. For example, the company could value the shares based on net asset value or profit, and factor in the expected volatility of that net asset value or profit.

Expected dividends (IFRS 2.B31-36)
Whether expected dividends should be taken into account in determining the fair value of the shares or options granted depends on whether the other contracting party is entitled to the dividend or dividend equivalents. For example, if employees have been granted options and are entitled to receive dividends on the underlying shares or dividend equivalents (in the form of cash or a reduction in the exercise price) between the grant date and the exercise date, the options granted should be valued as if no dividend will be paid on the underlying shares, i.e. the input value for the expected dividend should be zero. Similarly, when the fair value, at grant date, of shares granted to employees is estimated, no adjustment is required in respect of expected dividends if the employee is entitled to dividends paid during the vesting period.

On the other hand, if the employees are not entitled to dividends or dividend equivalents during the vesting period (or, in the case of an option, before exercise), expected dividends should be taken into account when valuing the right to shares or options on the grant date. That is, when estimating the fair value of an option granted in the option pricing model used, the expected dividend must be taken into account. When the fair value of a granted share is estimated, the resulting value should be reduced by the present value of dividends expected to be paid during the vesting period.

An expected dividend yield is commonly used in option pricing models. However, the models can be adapted to work with an expected dividend amount instead of a rate of return. A company can use either expected yield or expected payments. If the company uses the latter, it should take into account the historical pattern in dividend growth. For example, if a company has a policy of increasing dividends by three per cent annually, the company should not assume a fixed dividend amount over the life of the option when determining the estimated option value unless there is evidence to support this assumption. The assumption regarding the expected dividend should generally be based on publicly available information. A company that does not pay a dividend and has no plans to do so should assume an expected dividend yield of zero. However, an emerging company that has not paid a dividend in the past could expect to start paying dividends during the expected life of the employee stock options. Those companies would use an average of their past dividend yield (zero) and the average dividend yield of an appropriate comparable group of companies.

Risk-free interest rate (IFRS 2.37)
The risk-free interest rate is normally the current implied yield on zero-coupon government bonds issued by the country whose currency is used to express the exercise price, with a residual maturity equal to the expected life of the option being valued (based on the remaining contractual maturity of the option, taking into account expected early exercise). It may also be necessary to use an appropriate substitute if such government bonds do not exist or if there is evidence that the implied return on zero-coupon government bonds is not representative of the risk-free interest rate (e.g. in high-inflation economies). An appropriate substitute should also be used if, when estimating the fair value of an option with a maturity equal to the expected life of the option being valued, market participants typically determine the risk-free interest rate using that substitute.

Impact on capital structure (IFRS 2.B38-41)
Third parties, other than the company, typically write traded share options. When these share options are exercised, the writer delivers the shares to the option holder. Those shares will be acquired from existing shareholders. Hence, the exercise of traded share options has no dilutive effect. However, if the share options are written by the company, new shares are issued upon exercise of those share options (either actually issued or issued in substance, if previously repurchased own shares are used). Since the shares are issued at the exercise price and not at the current market price on the exercise date, this actual or potential dilution may lead to a fall in the share price. As a result, the option holder's profit following exercise is smaller than when exercising an otherwise similarly traded option that does not dilute the share price. Whether this has a significant impact on the value of the share options granted depends on several factors, such as the number of new shares issued upon exercise of the options compared to the number of shares already issued. Moreover, if the market already expects the option grant, the market has already factored the potential dilution into the share price on the grant date. However, the company should assess whether the potential dilutive effect of the future exercise of the share options granted could affect the estimated fair value of the options on the grant date. Option pricing models offer the possibility of taking this potential dilution effect into account.

28.13 Presentation and disclosure

28.13.1 Presentation

Goods or services received in exchange for a share-based payment should be presented in the financial statements in the same way as if they were received in a cash-settled transaction. This means, for example, that the costs of options granted to employees are presented as part of employee benefits expense(DAS 275.501).

The liability to be recognised in respect of (cash-settled) share-based payments is presented either as a provision or as a debt. A liability should be classified as a provision if the amount or timing of settlement is uncertain. In all other cases, the liability should be recognised as a debt (DAS 275.503).

28.13.2 Notes

General
An entity should provide information on the nature and extent of share-based payments during the reporting period. To this end, the principal provisions of the contracts underlying these payments are included (DAS 275.504). These provisions include a description of each type of share-based payment that existed at any time during the period, including the principal conditions of each contract, such as vesting conditions, the maximum life of options granted, and the settlement method (e.g. settlement in equity instruments or in cash). An entity with substantially similar types of share-based payment may disclose this information on an aggregate basis, unless separate disclosure is required to comply with the principle of DAS 275 (DAS 275.504).

The amount of share-based payment recognised during the financial year in accordance with DAS 275 should be disclosed in the notes. The amount recognised under wages should be disclosed separately (DAS 275.505).

Where the expenses resulting from share-based payments relate to transactions with management board members or supervisory directors, they should be included in the recognition of remuneration as referred to in Article 2:383 NCC (DAS 275.506).

An entity should disclose which measurement basis was used (fair value or intrinsic value). Information should also be provided on how the fair value, or intrinsic value for share options, was determined in the recognition of the share-based payment (DAS 275.507). This may include the following information (DAS 275.507):

- the market price used to determine fair value;
- the (option) pricing model used and the data used;
- whether and how any price-related conditions were recognised in the determination of fair value.

An entity should disclose in the notes (DAS 275.508):

- its policy for hedging granted share options; this may include buying back its own shares, acquiring call options on its own shares and placing new shares;
- the position as at reporting date of share options granted and not yet hedged; and
- (if at reporting date hedging took place fully or partly by means of the repurchase of own shares, acquisition of call options on own shares or a similar transaction), the average prices paid for these.

The provisions of Article 2:378 NCC on the change in equity during the financial year should be applied to movements in reserves. In each case, the following should be presented separately (DAS 275.509):

- the movements related to granted equity instruments; and
- the movements related to the exercise of equity instruments such as share options.

Share options granted to employees
Pursuant to Article 2:383d NCC, a non-listed open public limited liability entity must disclose the following information, for each management board member and supervisory board member individually and for the other employees collectively, regarding options on shares of the entity itself and on shares of group entities controlled by the entity:

- the exercise price of the rights and the price of the underlying shares in the entity's capital if that exercise price is lower than the price of those shares at the time the rights are granted;
- the number of share options not yet exercised at the beginning of the financial year;
- the number of share options granted by the company during the financial year with the most important of the conditions attached to them; if such conditions are changed during the financial year, these changes should be disclosed separately;
- the number of share options exercised during the financial year, indicating in any case the number of shares corresponding to such exercise and the exercise prices;
- the number of share options not yet exercised at the end of the financial year, with disclosure of:
  - the exercise price of the granted options;
  - the residual life of the unexercised options;
  - the principal conditions governing exercise of the options;
  - a financing arrangement made when the options were granted;
  - other data relevant to assessing the value of the options; and
- if applicable: the criteria used by the entity to grant or exercise the options.

For entities that do not qualify as open public limited liability entities (open NVs), it is recommended that the disclosures required for open NVs be included. If this recommendation is followed, the Dutch Accounting Standards Board emphasises that this disclosure can be included for all management board members and supervisory directors collectively (DAS 275.510).

28.14 Exemptions for **medium-sized and small entities**

No exemptions apply to medium-sized entities.

For recognition and measurement of option schemes (including employee share option schemes), small entities do not have exemptions (DASsmall B8.135 and B14.129). Small entities need only include the information required by law in the notes and may consider incorporating additional information ('over and above the legal minimum') in the notes.

28.15 Significant differences from IFRS

Measurement of share options granted to employees

IFRS 2 'Share-based Payment' does not have DAS 275's option to recognise share options granted to employees at intrinsic value instead of fair value. Under IFRS 2, recognition at intrinsic value is only allowed if an entity is unable to reliably estimate the fair value of the equity instruments (including share options) granted.

Share-based payments within a group

IFRS 2 provides that an entity that receives goods or services under a share-based payment must also recognise those goods or services in its financial statements, regardless of which group entity makes the share-based payment. For example, if a holding entity has granted a share option scheme to employees of an operating entity, and that scheme is also settled by that holding entity, the operating entity must recognise a share-based payment in the financial statements. This is because the operating entity receives the employee's services.

DAS 275 need not be applied for the recognition of share-based payments initiated or settled by a person or company not included in the consolidation scope of the entity (DAS 275.103a). Thus, under DAS 275, the operating entity in the above example does not have to recognise a share-based payment in its financial statements. However, the operating entity may choose to do so.

Annex 1. Example of recognition of share options granted to employees (extracted from DAS 275)

The example below discusses the recognition of a employee share option scheme in the financial statements for the following four scenarios:

1. settlement in shares (= equity instruments), recognition based on the fair value of the share options;
2. settlement in shares, recognition based on the intrinsic value of the share options;
3. settlement in cash, recognition based on the fair value of the share options; and
4. settlement in cash, recognition based on the intrinsic value of the share options.

The following details are relevant:

- The entity grants 100 share options to 200 employees on 1 January of year 1.
- Each share option gives the right to buy 1 share at an exercise price of 50. The options can only be exercised one day after they vest.
- The options vest if the employees concerned remain in service for three years from the grant date.
- The fair value of the share on 1 January of year 1 is 50. On the subsequent reporting dates, the fair value is as follows: 45, 55 and 65.
- The entity has the following expectations of the percentage of employees that will remain employed for the full three years: year-end year 1: 80%, year-end year 2: 85%. At the end of year 3: 75% of the employees concerned were found to be still employed.

Based on the data included above, the following measurements can be derived:

	Share price	Intrinsic value option	Time value option	Fair value option
1 January of year 1	50	0	5	5
31 December of year 1	45	0	3	3
31 December of year 2	55	5	1	6
31 December of year 3	65	15	0	15

The fair value and time value of the option can be determined using an option pricing model. In this example, the time value is notional.

The recognition depends on whether the share option scheme is settled in equity instruments or in cash and also on the entity's choice of accounting policy with regard to recognition on the basis of fair value or intrinsic value.

The recognition for the four scenarios can be summarised as follows:

Scenarios	Year	Expense in P&L	Movement in liability	Movement in equity excl. profit or loss	Profit or loss	Movement in equity incl. profit or loss
1. Settlement in equity instruments-Fair value						
(= 80% x 200 x 100 x 5 x 1/3)	1	26,667	-	26,667	(26,667)	-
(= 85 x 200 x 100 + 5 x 2/3 - 26,667)	2	30,000	-	30,000	(30,000)	-
(= 75% x 200 x 100 x 5 x 3/3 - 56,667)	3	18,333	-	18,333	(18,333)	-
	Total	75,000	-	75,000	(75,000)	-
2. Settlement in shares – Intrinsic value						
(= 80% x 200 x 100 x 0 x 1/3)	1	-	-	-	-	-
(= 85% x 200 x 100 x 5 x 2/3 - 0)	2	56,667	-	56,667	(56,667)	-
(= 75% x 200 x 100 x 15 x 3/3 - 56,667)	3	168,333	-	168,333	(168,333)	-
	Total	225,000	-	225,000	(225,000)	-
3. Settlement in cash – Fair value						
(= 80% x 200 x 100 x 3 x 1/3)	1	16,000	16,000	-	16,000	16,000
(= 85% x 200 x 100 x 6 x 2/3 - 16,000)	2	52,000	52,000	-	52,000	52,000
(= 75% x 200 x 100 x 15 x 3/3 - 68,000)	3	157,000	157,000	-	(157,000)	(157,000)
	Total	225,000	225,000	-	(225,000)	(225,000)
4. Settlement in cash – Intrinsic value						
(= 80% x 200 x 100 x 0 x 1/3)	1	-	-	-	-	-
(= 85% x 200 x 100 x 5 x 2/3 - 0)	2	56,667	56,667	-	(56,667)	(56,667)
(= 75% x 200 x 100 x 15 x 3/3 - 56,667)	3	168,333	168,333	-	(168,333)	(168,333)
	Total	225,000	225,000	-	(225,000)	(225,000)

In the following, scenario 1 has been worked out using journal entries. Brief explanation is given on scenarios 2 to 4.

Explanation on scenario 1
Recognition in year 1 is as follows:

Costs of share option scheme (= 80% x 200 x 100 x 5 x 1/3)	26,667	
Equity		26,667

The calculation thus takes into account the estimate of the number of employees expected to remain employed for the full three years, as well as the straight-line allocation of expenses over the vesting period.

For the entry in equity, the nominal share capital is always credited for the number of shares delivered at face value. The remaining amount is recorded in the share premium reserve.

Recognition in year 2 is as follows:

Costs of share option scheme (= 85% x 200 x 100 x 5 x 2/3 - 26,667)	30,000	
Equity		30,000

The costs in year 2 were determined by first determining the cumulative expense (= 56,667) and then deducting from this the expense already recognised in year 1 (= 26,667).

Recognition in year 3 is as follows:

Costs of share option scheme (= 75% x 200 x 100 x 5 x 3/3 - 56,667)	18,333	
Equity		18,333

The costs in year 3 were determined by first determining the cumulative expense (= 75,000) and then deducting from this the cumulative expense recognised at the end of year 2 (= 56,667).

Explanation on scenario 2
When applying the intrinsic value method, the intrinsic value is determined on each reporting date. As the intrinsic value on the various reporting dates is higher than the fair value at grant date, the expense in year 1 is lower than under scenario 1 and the expenses in year 2 and year 3 are cumulatively higher.

Explanation on scenario 3
When settlement is in cash and measurement at fair value, recognition on each reporting date is based on the fair value of the liability at that time. Under scenario 3, the liability is presented as a provision, as the amount is uncertain.

Explanation on scenario 4
When settlement is in cash and measurement at intrinsic value, the amounts recognised are equal to the amounts under scenario 2. However, under this scenario, there is recognition of a liability.

Alternative change in share value
If at 31 December of year 3 the fair value of the share is 45 and the options therefore expire being worthless, the following valuations of the options can be derived:

	Share price	Intrinsic value option	Time value option	Fair value option
1 January of year 1	50	0	5	5
31 December of year 1	45	0	3	3
31 December of year 2	55	5	1	6
31 December of year 3	45	0	0	0

The recognition for the four scenarios can be summarised as follows:

Scenarios	Year	Expense in P&L	Movement in liability	Movement in equity excl. profit or loss	Profit or loss	Movement in equity incl. profit or loss
1. Settlement in equity instruments-Fair value						
(= 80% x 200 x 100 x 5 x 1/3)	1	26,667	-	26,667	(26,667)	-
(= 85 x 200 x 100 + 5 x 2/3 - 26,667)	2	30,000	-	30,000	(30,000)	-
(= 75% x 200 x 100 x 5 x 3/3 - 56,667)	3	18,333	-	18,333	(18,333)	-
	Total	75,000	-	75,000	(75,000)	-
2. Settlement in shares – Intrinsic value						
(= 80% x 200 x 100 x 0 x 1/3)	1	-	-	-	-	-
(= 85% x 200 x 100 x 5 x 2/3 - 0)	2	56,667	-	56,667	(56,667)	-
(= 75% x 200 x 100 x 0 x 3/3 - 56,667)	3	(56,667)	-	(56,667)	56,667	-
	Total	-	-	-	-	-
3. Settlement in cash – Fair value						
(= 80% x 200 x 100 x 3 x 1/3)	1	16,000	16,000	-	16,000	16,000
(= 85% x 200 x 100 x 6 x 2/3 - 16,000)	2	52,000	52,000	-	52,000	52,000
(= 75% x 200 x 100 x 0 x 3/3 - 68,000)	3	(68,000)	(68,000)	-	68,000	68,000
	Total	-	-	-	-	-
4. Settlement in cash – Intrinsic value						
(= 80% x 200 x 100 x 0 x 1/3)	1	-	-	-	-	-
(= 85% x 200 x 100 x 5 x 2/3 - 0)	2	56,667	56,667	-	(56,667)	(56,667)
(= 75% x 200 x 100 x 0 x 3/3 - 56,667)	3	(56,667)	(56,667)	-	56,667	56,667
	Total	-	-	-	-	-

Explanation on scenario 1
The fact that the share options expire being worthless has no effect on the recognition under this scenario, as the recognition is based on the fair value on the grant date. The change in the fair value of the share no longer affects this.

Explanation on scenarios 2, 3 and 4
Because in scenarios 2, 3 and 4 cumulative recognition over the years is done based on the value on the respective reporting dates, on balance in year 3 the entire expense is reversed.

Cancellation or early settlement
The following sets out the recognition if, assuming the original change in value in the example, the entity decides to settle the scheme early for an amount of 108,000 at the end of year 2. This assumes that 90% of the employees concerned are still employed at that time and all of them are eligible for the early settlement. The elaboration of this is set out in journal entries for the four scenarios.

Re 1. Settlement in shares, recognition based on fair value of the share options
The recognition of additional costs is as follows:

Costs of share option scheme (= 90% x 200 x 100 x 5 - 6,667)	33,333	
Equity		33,333

The remaining costs for allocation are recognised directly in profit or loss based on the employees still employed at the time of settlement.

The settlement in cash of the share option scheme is recognised as follows:

Equity	108,000	
Bank		108,000

The settlement is recognised as a repurchase of equity instruments and therefore charged directly to equity.

Re 2. Settlement in shares, recognition based on the intrinsic value of the share options
The result is the same as under scenario 1. It should be noted, however, that the amount to be recognised is based on the intrinsic value at the end of year 2 (5), which coincidentally equals the fair value at the time of grant, on which the recognition of scenario 1 is based.

Re 3. Settlement in cash, recognition based on the fair value of the share options
The recognition of additional costs is as follows:

Costs of share option scheme (= 108,000 - 68,000)	40,000	
Liability		40,000

The additional costs recognised at the time of settlement are equal to the amount of the settlement minus the liability already accrued.

The recognition of the settlement against the liability is recognised as follows:

Liability	108,000	
Bank		108,000

Re 4. Settlement in cash, recognition based on the intrinsic value of the share options
The recognition of additional costs is as follows:

Costs of share option scheme (108,000 - 56,667)	51,333	
Liability		51,333

The additional costs recognised at the time of settlement are equal to the amount of the settlement minus the liability already accrued.

The recognition of the settlement against the liability is recognised as follows:

Liability	108,000	
Bank		108,000

29 Government grants and other forms of government assistance

29.1 Introduction

Government grants are government contributions to an entity (or to a specific category of entities) if the entity meets or has met certain conditions as regards its operational activities (DAS 274.0). These may be monetary contributions or other benefits capable of being expressed in monetary terms. These grants should be distinguished from regular sales transactions with the government conducted in the ordinary course of business. Government grants are one example of the broader concept of government assistance. Government assistance is defined as government actions directly aimed at providing economic benefits to an entity or to a specific category of entities that meet certain criteria (DAS 274.0). Government means local authorities, state governments or international authorities as well as government bodies and similar authorities (DAS 274.0).

Government grants referred to in this chapter are categorised as follows:

- operating grants;
- financing facilities;
- development loans; and
- investment grants.

29.2 General criteria for recognition

Grants and other forms of government assistance are recognised in the financial statements as soon as there is reasonable certainty that (DAS 274.107):

- an entity meets the relevant requirements; and
- the government grant in question or other form of government assistance will actually be obtained.

29.3 Operating grants

29.3.1 Definition

Operating grants are (DAS 274.0):

- grants for expenditures that are recognised as costs in the year of expenditure; or
- grants obtained for certain lost revenue or for operating deficits in general.

29.3.2 Recognition and measurement

Operating grants are recognised as income in the profit and loss account in the financial year in which the subsidised expenditures are recognised in the profit and loss account, or in which the lost revenue or the operating deficit occurred (DAS 274.108).

Examples of operating grants are:

- wage grants;
- grants for education and training; and
- grants for export promotion.

One example of an operating grant is the grant awarded under the Research and Development Promotion Act (*Wet bevordering speur- en ontwikkelingswerk* ("WBSO")). Under this act, a company can claim a subsidy for the portion of its wage costs spent on research and development work. This grant consists of a reduction in payroll taxes withheld and subsequently payable by the company where the employees in question work. This operating grant, which is in the form of a tax credit, is usually deducted from research and development costs in the financial statements, unless these costs are capitalised. In that case, this grant is in nature an investment grant and is recognised as described in paragraph 29.6.

Operating grants received for projects that extend beyond the reporting date are recognised in the years in which the budgeted or actual expenditure takes place (DAS 274.108). The allocation to different years depends on the content of the grant decision, the year in which the grant funds are actually spent and the exact grant terms and conditions. Of relevance here is whether there is still a potential repayment obligation on the reporting date or whether the grant has actually been realised by that date (no repayment obligation).

Example: Operating grant

For a two-year project with an estimated project cost of 200, an operating grant of 50 will be received. The grant is received in year 1. There is only a repayment obligation if and to the extent that the costs incurred for this project are less than 50.

Situation a: at the end of year 1, costs of 40 have been incurred; grant income of 40 is then recognised and grant received in the amount of 10 is recognised as accruals and deferred income.

Situation b: at the end of year 1, costs of 80 have been incurred; the entire amount of grant received, in the amount of 50, is then recognised as grant income.

Another possible situation is that, according to the grant terms and conditions, the grant must be repaid *pro rata* if the project costs are lower than budgeted. In that case, the grant received is recognised as income *pro rata* to the costs incurred, as follows:

Situation a: 20% (= 40 / 200) of the budgeted costs have been incurred; grant income of 10 is then recognised (= 20% of 50).

Situation b: 40% (= 80 / 200) of the budgeted costs have been incurred; grant income of 20 is then recognised (= 40% of 50).

If important grant terms and conditions have not yet been met, any grant already received should be recognised entirely as a liability on the balance sheet.

29.3.3 Presentation

Operating grants are presented in the profit and loss account (DAS 274.111):

- as revenue (under a general item such as 'other operating revenue' or as a separate item); or
- deducted from any related costs.

One important factor when presenting operating grants is the nature of the grant. Operating grants in the form of grants for expenditure can be presented using either of the above methods. The first presentation method makes it easier to understand the gross amounts of related costs. The second method underlines the fact that some of the costs might not have been incurred if the grant had not been available. Another argument for this method is that the grant received should be used to pay those costs.

Operating grants for certain lost revenue and for operating deficits in general are presented under revenue.

29.4 Financing facilities

29.4.1 Definition

Financing facilities are grants linked to a loan, such as in the form of subordination, cancellation if certain conditions are met, or a lower-than-market interest rate (DAS 274.0).

Examples of financing facilities include:

- subordinated loans, including capital loans;

- contingent financing other than development loans.

29.4.2 Recognition and measurement

A facility linked to a loan is disregarded when recognising the receipt of that loan. The amount of the loan is recognised as debt in the balance sheet (unless it is a development loan; see paragraph 29.5). When it is evident that the loan does not need to be repaid, it is then determined whether the released amount should be recognised as an operating grant or an investment grant (DAS 274.109).

The waived amount is considered an investment grant if the loan has been used to finance expenditures allocated to the number of years in which the expenditure produces a useful effect. If the waived amount has been used to finance expenditures recognised as costs in the year of expenditure, it will be recognised as an operating grant.

If a loan is provided by a government or public authority at a lower interest rate than the prevailing market rate, the benefit thus obtained is recognised as a government grant. This is done by recognising and measuring such loans at fair value in accordance with DAS 290 'Financial instruments' (see paragraph 21.6.3). This means that, on initial recognition, such a loan is measured at (lower) fair value. The difference with the higher amount received is the present value of the benefit due to the lower interest rate. This benefit is recognised as a government grant in accordance with the provisions on the recognition of government grants (DAS 274.110). This means that this benefit is recognised as an operating grant or an investment grant, depending on the purpose for which the loan was obtained.

Example: loan secured at below-market interest rate

Company A obtains a government loan of 100,000 at 2% interest per annum for the (partial) financing of a research and development project. Interest is payable annually in arrears. The loan will be repaid in full after three years.

Let us assume that the market interest rate for such a loan is 5%. The fair value at the time the loan was obtained was 91,830. This is equal to the present value of the interest and repayment amounts discounted at 5% interest. The loan is now measured at this sum of 91,830 (and subsequently measured at amortised cost). The difference of 8,170 compared to the sum of 100,000 received relates to the government grant received, which A recognises as an operating grant or investment grant, depending on its nature (DAS 274.110).

29.5 Development loans

29.5.1 Definition

Development loans are loans obtained to finance development costs. If there is a technical or commercial failure, such loans are cancelled over time. In the event of success, interest and repayment will be due over time. Generally, repayment is linked to the revenue or profit or loss generated as a result of development activities (DAS 274.0).

29.5.2 Presentation

If the repayment of a development loan is contingent on the revenue or financial outcome of the financed project, the loan received is deducted from the actual development costs (DAS 274.111a).

From the time that repayment is required based on the favourable financial outcome of the project, the annual repayments consisting of interest and repayments are recognised as costs or revenue (DAS 274.111a).

Example: recognition of a development loan

Company A received a development loan of 1,000 for project Y in year T. Of every 500 in revenue related to project Y, 10% of the development loan has to be repaid plus interest of 4%. The sum of 1,000 received has been deducted from the capitalised development costs to which the development loan relates.

Situation 1. The project failed and it will not generate any revenue, or at least any such revenue will be less than budgeted. Method of recognition:

Once it is received, the development loan is deducted from development costs, whether capitalised or not. If the development costs are capitalised following deduction of the grant received, they are subsequently amortised outright (see also chapter 10) as no revenue is expected. If these net costs have not been capitalised, there is no reason for any entry.

Situation 2. The project succeeds and eventually generates a total revenue of 4,000. Method of recognition:

A total of 800 (= (4,000 / 500) x (10% of 1,000)) plus interest on the 'redemption' payable annually has to be repaid. This is recognised as cost of revenue in the year in which the payments are made. If the net costs have been capitalised, the asset is depreciated according to the applicable rules.

The contingent financial liability (the loan obtained including any interest) related to the development loan received is disclosed in the notes to the financial statements (DAS 274.121). The notes should explain the terms and conditions applicable to the grant of the loan (usually a target revenue or profit).

29.6 Investment grants

29.6.1 Definition

Investment grants are grants for expenditures allocated to a number of years in which that expenditure is deemed to produce a useful effect. These grants can be considered either as a reduction of the amount to be invested or as contributing to the financing of the investment (DAS 274.0).

29.6.2 Presentation

Investment grants can be presented in either of two ways (DAS 274.112-113):

1. As an amount received in advance under accruals and deferred income. These can be presented in the balance sheet under current or non-current debt. If accruals and deferred income are recognised in a separate section in the current debt, the extent to which the item is considered non-current should be indicated (DAS 258.107). A portion of the investment grant recognised in this way is then released and credited each year to the amortisation costs recognised in the operating profit or loss related to the subsidised investment. The amount released is determined systematically in line with how the use for which the grant was made is itself recognised in the financial statements.
2. As a reduction in the carrying amount of the subsidised investment. This method of recognition depreciates the balance as a result of which the subsidy is released to profit or loss simultaneously with the depreciation. If a sale within a certain period requires full or partial repayment of the grant, then, if the depreciation period is shorter than this period, this will be taken into account when determining the residual value. An investment grant may not be recognised as a separate item between equity and provisions.

If an investment grant is in the nature of a tax credit, its effects are recognised in the profit and loss account and credited to the item 'taxes'. If this means that the effective tax rate is then materially different, an explanation in the notes may be needed (DAS 274.117-119).

29.7 Recognition of emission allowances

The Dutch Accounting Standards Board has added an appendix to DAS 274 regarding the recognition of greenhouse gas emission allowances that have been obtained and purchased for no consideration. The recognition of such allowances under IFRS has previously caused a good deal of international controversy. This even led to the withdrawal of an interpretation of the IFRIC that had already been published. Therefore, the Dutch Accounting Standards Board does not prescribe a specific method of recognition, but rather discusses two options. Methods of recognition other than those referred to in this appendix are allowed, provided they comply with the general provisions of Title 9 Book 2 NCC and the Dutch Accounting Standards.

Since 2005, certain entities have been affected by the implementation in Dutch laws and regulations of the EU directive on greenhouse gas (CO_2) emission allowances. Under these laws and regulations, the government allocates emission allowances to designated entities at the beginning of a calendar year. Emission allowances provide entitlement to a certain quantity of CO_2. These allowances are freely tradable. For example, entities may sell allowances to or buy additional ones from third parties.

After the calendar year ends, actual CO_2 emissions are determined and entities must surrender emission allowances equal to the total of those actual emissions. If a company has a deficit, it will owe a penalty and (within certain limits) that deficit can be deducted from its allowances for the following year.

Method of recognition 1
Under method of recognition 1, emission allowances are recognised as follows:

- emission allowances granted by the government are initially measured, at the time of acquisition, at their current value as an intangible fixed asset (this current value is then assumed to be the cost for the purpose of further recognition). Emission allowances purchased subsequently are initially measured at acquisition cost;
- the difference between the initial measurement of allowances obtained directly from the government and their actual acquisition cost (acquisition cost is usually zero) is classified as a government grant and recognised as an accruals and deferred income. This item is then systematically credited to profit or loss over the life of the allowances, regardless of whether they are sold in the interim;
- the subsequent measurement of capitalised emission allowances is based on the initial cost (current value at the time of purchase). In principle, emission allowances are not amortised because they are only used when surrendered in settlement of the liability accrued through actual emissions;
- a liability (provision) is created for the actual emissions, to be measured at the carrying amount of the (needed) emission allowances available to the company. To the extent that emissions exceed the available allowances, that part of the provision is measured at the current value of allowances yet to be obtained. A provision is also created and charged to profit or loss for any penalty owed; and
- the liability is charged to profit or loss - or included in cost of produced assets, if applicable - in accordance with the emissions during the year.

Method of recognition 2
Under this method of recognition, emission allowances are recognised as follows:

- emission allowances allocated by the government are initially measured at the actual acquisition cost (mostly zero). This means that no government grant is recognised (and amortised) in the balance sheet as accruals and deferred income. Allowances purchased subsequently are initially measured at acquisition cost;
- capitalised emission allowances are subsequently measured at cost;
- a liability (provision) is only created for the actual emissions to the extent that they exceed the allocated allowances, to be measured at the current value of allowances yet to be obtained; and
- the liability is charged to profit or loss - or included in cost of produced assets, if applicable - in accordance with the emissions during the year. A provision is created and charged to profit or loss for any penalty owed.

The Dutch Accounting Standards have no specific rules regarding the recognition of government contributions in kind. Based on the general provision that an intangible fixed asset is initially measured at cost, the Dutch Accounting Standards Board considers it acceptable not to recognise government contributions in kind in the balance sheet. Given that the allowances are not recognised, it is acceptable in such instances not to create a provision for as long as the actual emissions are less than the allowances allocated.

Example: recognition of emission allowances (extracted from appendix to DAS 274)

On 1 January of any year, the government allocates to company A emission allowances of 12,000 tonnes of CO_2 for that year (which A obtains for no consideration). The current value of allowances is 10 per tonne on 1 January, 12 per tonne on 30 June and 11 per tonne on 31 December.

By 30 June, A has emitted 5,500 tonnes of CO_2 and, at that point, it expects to emit 12,000 tonnes over the entire year.

By 31 December, A has emitted 12,500 tonnes of CO_2.

A purchases additional emission allowances at the end of the year, paying 11 per tonne for 500 tonnes.

A does not produce any assets, so the provision created is charged directly to profit or loss.

Method of recognition 1 in detail

1 January

The emission allowances granted for the year are recognised at the deemed cost of 120,000 (= 12,000 tonnes x 10). The journal entry reads:

Intangible fixed assets	120,000	
Accruals and deferred income		120,000

30 June (if interim figures are prepared)

The government grant recognised as accruals and deferred income is amortised based on the ratio of actual emissions to estimated emissions: 55,000 (= (5,500 tonnes/ 12,000 tonnes) x 120,000). The journal entry reads:

Accruals and deferred income	55,000	
Operating expenses		55,000

30 June

The liability relating to actual emissions for the first half of the year is recognised: 55,000 (= 5,500 tonnes x 10 (deemed cost of the allowances allocated)). The journal entry reads:

Operating expenses	55,000	
Provision		55,000

31 December

The company buys additional emission allowances at 11 per tonne to avoid a deficit for the year as a whole: 5,500 (= 500 tonnes x 11). The journal entry reads:

Intangible fixed assets	5,500	
Bank		5,500

The remainder of the government grant recognised as accruals and deferred income is amortised: 65,000 (= 120,000 - 55,000). The journal entry reads:

Accruals and deferred income	65,000	
Operating expenses		65,000

The liability for actual emissions in the second half of the year is recognised. Of these 7,000 tonnes, 6,500 tonnes can be met from the initial emission allowances obtained (12,000 tonnes - 5,500 tonnes consumed in first six months = 6,500 tonnes). The initial cost of 10 applies to this portion, the total for which is therefore 65,000. The balance of 500 tonnes will be met from the additionally purchased allowances. The cost of this additional purchase is 11 per tonne, making the total for this portion 5,500. The total emission cost for the second half of the year is therefore 70,500. The journal entry reads:

Operating expenses	70,500	
Provision		70,500

At the beginning of the next financial year, the liability is then settled against the surrender of the emission allowances. The journal entry reads:

Provision	125,500	
Intangible fixed assets		125,500

Method of recognition 2 in detail

1 January

Emission allowances allocated for the year are recognised at cost. This is zero and, therefore, they are not recognised.

30 June (if interim figures are prepared)

The government grant recognised as accruals and deferred income is not amortised. As actual emissions are still lower than the allowances allocated, no liability is recognised as of 30 June.

On 31 December, the company buys additional emission allowances at 11 per tonne to avoid a deficit: 5,500 (= 500 tonnes x 11). The journal entry reads:

Intangible fixed assets	5,500	
Bank		5,500

31 December

Government grants recognised as accruals and deferred income are still not amortised. However, emissions for the financial year have exceeded the allocated allowances: 12,500 tonnes compared to 12,000 tonnes allocated. This means that a provision for 500 tonnes is created, which is measured at the current value of the allowances (obtained or yet to be obtained). In this case, this is 5,500 (= 500 tonnes x 11). The journal entry reads:

Operating expenses	5,500	
Provision		5,500

At the beginning of the next financial year, the liability is then settled against the surrender of the emission allowances. The journal entry reads:

Provision	5,500	
Intangible fixed assets		5,500

29.8 Disclosure

The following must be disclosed in the notes to the financial statements (DAS 274.121):

- the nature of government grants and other forms of government assistance obtained;
- how these government grants and other forms of government assistance have been recognised in the financial statements;
- the amount of government grants and government assistance recognised in the financial year; and
- the contingent financial liabilities related to development loans received.

These disclosure requirements generally apply to all forms of government grants and other forms of government assistance discussed above.

29.9 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

Small entities may measure the amount recognised as a liability in the balance sheet relating to a government loan made at a below-market interest rate at the face value of the loan if this results in the correct allocation of the government grant over the period in question. In this case, only the nominal interest actually relating to the financial year is recognised in the financial statements. The liability then does not have to be measured at the lower fair value upon initial recognition (DASsmall B17.110).

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

29.10 Significant differences from IFRS

Non-monetary investment grants
According to IAS 20 'Accounting for Government Grants and Disclosure of Government Assistance', a non-monetary investment grant and the related asset (e.g. land) are, in principle, measured at fair value at the time of acquisition. Alternatively, the asset and the government grant may be recognised at a nominal amount (which may be zero) (IAS 20.23).

The Dutch Accounting Standards do not contain any rules on this other than that, in general, transactions should be recognised on the basis of economic reality (DAS 115.107). On this basis, recognition at fair value is the obvious choice, as it reflects the economic reality.

30 Specific parts of the notes to the financial statements and other notes

30.1 General

This chapter covers some general features as well as some specific sections of the notes, namely:

- function and presentation of the notes (paragraph 30.2);
- related parties (paragraph 30.3);
- earnings per share (paragraph 30.4);
- discontinuance of operations (paragraph 30.5);
- segmented information (paragraph 30.6);
- disclosure of audit fees (paragraph 30.7);
- off-balance-sheet arrangements (paragraph 30.8);
- rendering of services under concessions (paragraph 30.9);
- notes to judgements, estimates and uncertainties (paragraph 30.10); and
- key figures, key ratios and multi-year overviews (paragraph 30.11).

30.2 Function and presentation of the notes

Function
Pursuant to Article 2:361(1) NCC, the notes, other than the management board report and Other information to be prepared by the management board, form part of the financial statements (DAS 300.101). The balance sheet and profit and loss account should be independently readable and thus give a true and fair view of the size and composition of equity and profit or loss even without explanatory notes (DAS 300.102). It is therefore not permitted to include in the notes any texts and/or amounts that can be considered corrections to texts and/or amounts included on the balance sheet and/or profit and loss account.

The purpose of the notes is to provide reliable information relevant to the decision-making of the users of the financial statements. Understandability and comparability are also important when providing information in the notes (see also paragraph 2.4.3).

Examples of information that may be relevant to users are (DAS 300.101a):

- the nature and financial impact of transactions on the entity;
- the nature, amount, timing and uncertainty of items on the balance sheet and profit and loss account and their impact on the entity's financial position, profit or loss and cash flows; and
- the nature of risks and the entity's exposure to them.

Where applicable, the notes include (DAS 300.103):

- an explanation of the basis for measurement of assets and liabilities and determination of the profit or loss;
- an explanation of the consolidation principles;
- additional financial overviews (examples: additional information on equity and profit or loss on alternative basis and cash flow statement);
- details and information required by law to be included in the notes, such as movement schedules, statements of turnover, details of inventories and details of items combined on the balance sheet or profit and loss account;
- other details for the insight into equity and profit or loss; and
- information that by its nature or use does not belong on the balance sheet and profit and loss account (examples include information on related parties and contingent liabilities).

References to the notes
The notes are logically divided, preferably in the form of a general and a specific section. Large entities must also include a reference to the accompanying notes to the items on the balance sheet, profit and loss account and cash flow statement (DAS 300.104). Notes should be classified to serve clarity and maintain the order in which items are listed (Article 2:363(1) NCC and DAS 300.104).

General part of the notes
An entity discloses the following in the notes: (a) the name, (b) the legal form and (c) the statutory registered office of the entity as well as (d) the number assigned by the Chamber of Commerce under which the entity is registered in the Commercial Register (Article 2:380b NCC).

The general part of the notes also (if not already included elsewhere in the financial statements or jointly published information with them) includes (DAS 300.105):

- address, registered office and actual place of business (if different from the registered office); and
- a description of principal activities.

The general part may also include (DAS 300.105):

- the accounting principles applied, including the choices made in this respect. A particular accounting principle is disclosed separately if it contributes to an insight how particular transactions and events are recognised in the financial statements (DAS 300.106a);
- the changes in accounting principles and presentation made to the financial statements;
- the method of allocating income and expenses to successive reporting periods;
- the treatment of taxes, foreign currency, intangible fixed assets and special provisions;
- the consolidation criteria applied;
- purchases and sales of participating interests and of (consolidated) group entities;
- the decisive significance of certain events for the interpretation of the financial statements; and
- information on loss-making activities and/or discontinuity of certain activities.

Disclosure on which standards have been used to prepare the financial statements
Pursuant to Article 2:362(10) NCC, an entity discloses in the notes which standards have been used to prepare the financial statements. This means disclosing whether the financial statements have been prepared in accordance with IFRS-EU or with the statutory provisions of Title 9 Book 2 NCC (or possibly in accordance with generally acceptable standards in one of the other Member States of the European Communities). This applies to both consolidated and company-only financial statements.

Comparative figures
Items in the financial statements include, wherever possible, the corresponding amounts from the previous financial year (Article 2:363(5) NCC). This also applies to all monetary amounts disclosed in the notes (DAS 110.127 and 300.107). In addition, the notes should include comparative information in a descriptive sense relating to the previous financial year, if this improves the required insight into equity and/or profit or loss (DAS 300.107).

The Dutch Accounting Standards Board has determined that for movement schedules, comparative figures should only be included if explicitly prescribed in a specific standard (DAS 110.127). This is only the case for the equity movement schedule (DAS 240.237). For other items for which movement schedules are to be included, inclusion of comparative figures is only recommended if this is important for the insight into the item in question.

Comparative figures in first financial year
Article 2:363(5) NCC only requires comparative figures for the previous financial year. This means that if there is no previous financial year (i.e. in the first financial year), no comparative figures need to be included. It is then not possible to include comparative figures for the previous financial year because there is no previous financial year. However, figures from the opening balance sheet can be included as comparative figures on the balance sheet. In principle, the opening balance sheet refers to the date of incorporation. The inclusion of figures of the opening balance sheet at the time of incorporation is our preference, but not mandatory.

30.3 Related parties

Introduction

When perusing a company's financial statements, it is important to know whether the company is entirely independent or whether it is in relation to certain related parties. In the latter case, related parties and related party transactions must be disclosed in the financial statements in certain cases. This is regulated in Article 2:381(3) NCC:

> 'Significant transactions entered into by the entity not under normal market conditions with related parties as defined by the standards adopted by the International Accounting Standards Board and approved by the European Commission, the size of those transactions, the nature of the relationship with the related party, as well as other information about those transactions necessary for an insight into the financial position of the entity must be disclosed. Information on individual transactions may be combined according to their nature unless separate information is needed to provide insight into the impact of related party transactions on the entity's financial position. Transactions between two or more members of a group need not be disclosed, provided subsidiaries party to the transaction are wholly owned by one or more members of the group.'

Medium-sized private limited liability entities and small entities are exempt from the application of this provision. For a medium-sized public limited liability entity, disclosure is limited to only transactions directly or indirectly entered into between the company and its principal shareholders and between the company and its members of the management board and of the supervisory board (Article 2:397(6) NCC).

For the term 'related party', the legislator has aligned with IFRS. According to Article 2:381(3) NCC, the definition of related parties as referred to in the standards adopted by the International Accounting Standards Board and approved by the European Commission (DAS 330.102) must be used. This definition is included in IAS 24.

A related party transaction is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged (DAS 330.0).

A transaction of significance is a transaction that can affect the economic decisions users make based on the financial statements (DAS 330.0). According to the Explanatory Memorandum (parliamentary papers 119783), the term 'significant transactions' should be understood as transactions that are 'material'. The concept of materiality has both quantitative and qualitative aspects. See also paragraph 2.4.3.

A transaction under normal market conditions between related parties is a transaction that takes place on the basis of a market price and other market conditions, as if independent parties were involved (DAS 330.0).

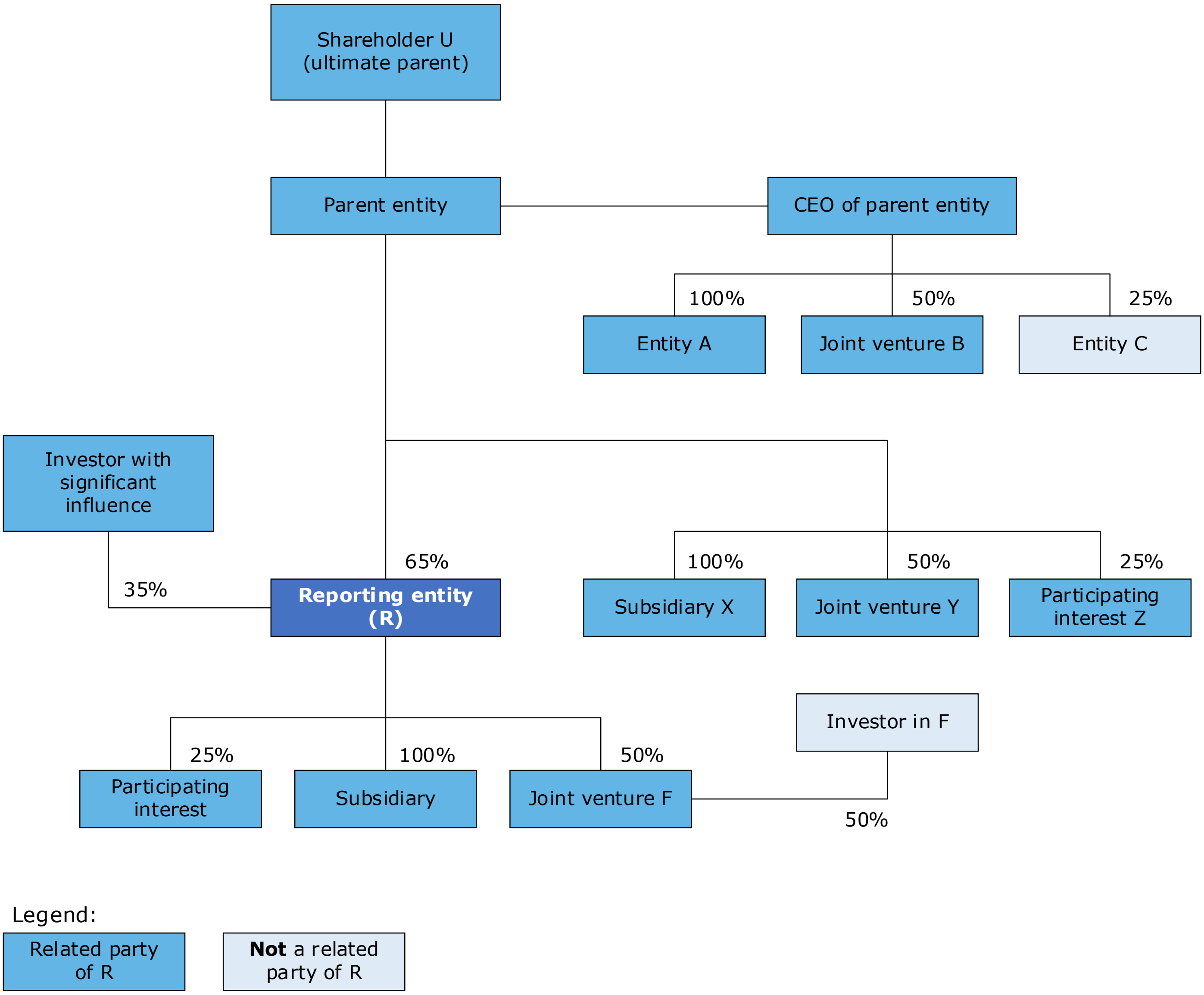
The definition of related parties under IFRS (IAS 24.9) distinguishes between natural persons that are related to the entity preparing its financial statements (the reporting entity), and entities that are related. Related parties of the reporting entity include:

Natural persons who are related parties:	Examples
Persons who control or jointly control the reporting entity (IAS 24.9(a)(i)).	Person X is director-major shareholder of company Y. X is a related party of Y.
Persons having significant influence over the reporting entity (IAS 24.9(a)(ii)).	Person X holds a minority interest amounting to 30% in company Y. X is a related party of Y.
Key management personnel who have, directly or indirectly, decision-making authority and responsibility for planning, directing and controlling the activities of the reporting entity or a parent entity thereof, including management board and supervisory board members (key management personnel) (IAS 24.9(a)(iii)).	Management board, supervisory board and senior management members.
Persons closely related to the aforementioned natural persons (IAS 24.9(a)).	Close relatives of natural persons are those relatives who can be expected to influence or be influenced by that natural person, in their business dealings with the entity. This could include the partner or children of the natural persons listed here.

An entity is related to a reporting entity if one of the following situations occurs:	Examples
The entity and the reporting entity are members of the same group (IAS 24.9(b)(i)).	Holding companies, group entities and sister companies. This therefore includes those group entities that are subsidiaries and sub-subsidiaries of the head of the group.
The entity is an associate or joint venture of the reporting entity (or a group entity thereof) (IAS 24.9(b)(ii)).	Company X is an associate of company Y, i.e. company Y can exercise significant influence over company X. X and Y are related parties.
Both entities are joint ventures of the same third party (IAS 24.9(b)(iii)).	A has two joint ventures, namely B and C. B and C are related parties.
The entity is a joint venture of a third party and the other entity is an associate of that third party (IAS 24.9(b)(iv)).	A has an interest in a joint venture B and in an associate C. B and C are related parties.
The entity is a 'post-employment benefit plan' for the benefit of employees of the reporting entity, or of any other entity that is a related party of the reporting entity. If the reporting entity itself is such a 'plan', then all affiliated sponsors/employers are also related parties (IAS 24.9(b)(v)).	A company pension fund. For the pension fund: affiliated employers.
The entity is controlled or jointly controlled by a natural person who is designated as a related party of the reporting entity (IAS 24.9(b)(vi)).	The CEO of reporting entity A holds a 100% interest in company X. The CEO has control over X. A and X are related parties.
A natural person who controls or jointly controls the reporting entity has significant influence over the entity or is a member of the entity's (or entity's parent's) key management personnel (IAS 24.9(b)(vii)).	Person X is majority shareholder of reporting entity A. X also holds a 25% interest in company Z. X controls A and has significant influence over Z. A and Z are related parties.
The entity, or any member of the group of which it is a part, provides key management personnel services to the reporting entity or to the parent entity of the reporting entity (IAS 24.9(b)(viii)).	Company Z manages A under a management agreement. A and Z are related parties.

The concept of 'control' corresponds to the concept of 'decisive influence' as defined in Chapter 33. The concept of 'significant influence' is defined in Chapter 9.

The scope of the definition of related parties from IAS 24.9 is illustrated in the following figure. In that figure, an interest greater than 50% should be considered an interest in which control is exercised. An interest equal to 50% is an interest in which joint control is exercised. An interest between 20% and 50% is an interest in which significant influence is exercised.



In the figure, only Entity C and Investor in F are not related parties of R.

Two companies are not automatically related parties because the director of the reporting company also acts as a director of the other party. Similarly, individual customers, suppliers, agents, distributors, etc. should not be classified as related parties merely by virtue of the economic dependency arising therefrom. In addition, two partners in a joint venture who have joint control over the joint venture are not related parties.

Transactions and disclosure of related party transactions
Disclosure of related party transactions applies to both the company-only and consolidated financial statements of an entity. In this context, it is important to note that transactions of an entity with certain group entities need not be disclosed. Article 2:381(3) NCC contains the following in this regard: 'Transactions between two or more members of a group need not be disclosed, provided subsidiaries party to the transaction are wholly owned by one or more members of the group'. This means that a transaction need not be disclosed in the company-only financial statements of a head of the group or 100% subsidiary if it is entered into with:

- the head of the group; or
- a group entity that is also 100% owned by group entities.

This exemption also applies to consolidated financial statements. Examples are transactions between two subsidiaries wholly owned by the parent. Transactions with non-100% group entities must therefore be disclosed. In addition, a subsidiary that is not itself 100% owned by the group cannot use this exemption.

It is also important to note that disclosures of related party transactions are subject to the general principles of materiality as with all other aspects of disclosures. Only material transactions from the perspective of the company-only and consolidated financial statements respectively require disclosure. This means, among other things, that non-material transactions between related parties do not require disclosure. The legally required insight is central to this. However, the legally required insight also entails that transactions between group entities for which there is, in principle, an exemption from disclosure under Article 2:381(3) NCC must be disclosed under Article 2:362(4) NCC if the provision of the insight referred to in Article 2:362(1) NCC requires this. The law requires that only transactions not entered into with related parties under normal market conditions are disclosed. However, the Dutch Accounting Standards Board recommends that material transactions entered into under normal market conditions should also be disclosed (DAS 330.201).

Examples of related party transactions are:

- purchase and sale of goods such as raw materials, semi-finished products, finished products and tangible fixed assets;
- rendering of services (including acting as agent);
- management contracts (see also paragraph 18.8);
- transfers under financing agreements (including loans and equity contributions in cash or in kind);
- lease contracts;
- transfers under licence agreements;
- issuing guarantees or other security;
- settling debts on behalf of an entity or by an entity for the benefit of another party; and
- transfers of research and development and knowledge.

If material transactions have been entered into by an entity with related parties and these transactions have not taken place under normal market conditions, the entity includes the following information according to the law (Article 2:381(3) NCC / DAS 330.201):

- the size of those transactions;
- the nature of the relationship with the related party; and
- other information on those transactions necessary to provide insight into the entity's financial position.

In doing so, transactions are disclosed separately as far as possible for the following categories (DAS 330.206):

- the parent entity;
- parties that can exercise joint control or significant influence over the entity;
- group entities;
- participating interests;
- joint ventures in which the entity is a participant;
- key officers in the entity's management or in the entity's parent entity; and
- other related parties.

Coherence with statement on remuneration of management board members and supervisory board members

One area in which non-market transactions between related entities regularly take place in practice is the charging (or non-charging) of all or part of the remuneration of management board members and supervisory board members to subsidiaries. This is discussed in more detail in paragraph 18.8.

Elements of related party transactions
The elements that may be important in the context of insight into the financial statements are (DAS 330.204):

- an indication of the size of transactions, in the form of an amount or a percentage of the amount that includes the transactions;
- amounts or percentages relating to transactions not yet settled; and
- the pricing policy applied in respect of the transactions that took place.

Examples of pricing policies between related parties include:

- pricing based on market prices;
- selling price minus or cost plus method or similar rules of thumb; and
- price is nil (i.e. nothing is charged on).

The last-mentioned example may be the case for transactions that are sometimes difficult to identify as such, such as the hiring or provision of management or staff or the contribution of equity (components).

Similar transactions may be disclosed in summary form, if insight permits (DAS 330.205).

Other disclosure of related parties
The law further includes disclosure requirements with respect to related parties in Article 2:379(3) and 2:414(1)(a and b) NCC. For these articles stipulate that an entity's financial statements must disclose the name and place of business of the entity that heads its group, as well as the name and place of business of each entity that integrally or proportionally consolidates the entity's financial information in its published consolidated financial statements. Each consolidating company must state the name and place of business of the entities it includes in the consolidation. The above can be clarified with the following diagram, assuming that both A and B prepare consolidated financial statements:

In the financial statements of:	Information to be provided
A. Parent	The name and place of business of B and C
B. Subsidiary, group entity of A	The name and place of business of A and C
C. Sub-subsidiary, group entity of A and B	The name and place of business of A and B

For related parties that are outside the group ('non-group'), the same disclosures often apply as for group entities (Article 2:361 (4) NCC). Related entities outside the group include (DAS 214.205):

a. non-group parent entities;
b. non-group subsidiaries of non-group parent entities;
c. non-group subsidiaries of group entities;
d. own non-group subsidiaries.

An example of (a) is a personal holding not qualifying as head of the group. An example of (b) is a subsidiary of the personal holding referred to in (a) belonging to another group. An example of (c) and (d) is an entity in which the majority of the supervisory board can be appointed, but on which no control can be exercised.

With regard to these non-group related parties the following disclosures should be included in the notes:

- shares, depository receipts or other forms of participation in these related parties (Article 2:367a NCC);
- receivables from these related parties (Article 2:367c and 370(1b) NCC) and debts to these related parties (Article 2:375(1f) NCC);
- securities provided to creditors of these related parties (Article 2:376 NCC);
- financial income and expenses from the relationship with these related entities (Article 2:377(5) NCC); and
- contingent liabilities from the relationship with these related entities (Article 2:381 NCC).

See also Annex 1 of Chapter 9 for an overview of the required disclosure of equity interests pursuant to Articles 2:379 and 414 NCC.

30.4 Earnings per share

Introduction
Entities may choose to disclose earnings per share in the financial statements. In that case, they should adhere to the related provisions included in DAS 340 (DAS 340.101). In annual accounts that include both consolidated and company-only financial statements, only consolidated earnings per share may be disclosed (DAS 340.102).

Calculation of earnings per share
Earnings per share are calculated by dividing net profit or loss attributable to holders of ordinary shares for the financial year by the weighted average of the number of ordinary shares outstanding during the financial year (DAS 340.201).

An ordinary share is an equity instrument that is subordinated to all other classes of equity instruments (DAS 340.0).

Earnings per share are calculated as follows:

Net profit or loss minus preference dividend = net profit or loss attributable to ordinary shares

Earnings per share = net profit or loss attributable to ordinary shares / number of ordinary shares*

* This is the weighted average number of shares outstanding during the financial year.

Preference dividends are defined as dividends declared for the financial year on non-cumulative preference shares plus dividends due (whether declared or not) for the financial year on cumulative preference shares (DAS 340.203).

The number of ordinary shares means the weighted average number of shares outstanding during the financial year. Repurchased own shares held within the group are not considered outstanding (DAS 340.204). Partly paid-up shares are included in proportion to their entitlement to dividends (DAS 340.207). The numbers are adjusted for changes in numbers that had no equity effect, such as share splits and bonus shares (DAS 340.209 and 210).

Example: Weighted average number of shares

	Issue	Repurchase	Outstanding
Balance as at 1 January			2,100
1 April		300	1,800
1 December	900	300	2,400
Balance as at 31 December			2,400

The weighted average number of shares is 1,925
(= (3 months x 2,100 + 8 months x 1,800 + 1 month x 2,400) / 12 months).

Diluted earnings per share
Diluted earnings per share are diluted earnings per ordinary share. For the purpose of calculating diluted earnings per share, potential ordinary shares that will lead to dilution are taken into account when determining the number of shares (DAS 340.211). A potential ordinary share is a financial instrument or other contract that gives the holder the right to ordinary shares. The number of dilutive shares is then added to the number of ordinary shares included in the denominator of the fraction for the calculation of diluted earnings per share.

The calculation of diluted net earnings takes into account all effects of dilution on dividend rights, interest and other revenues and expenses, as well as taxes (DAS 340.213).

If financial instruments may be settled by issuing shares, the maximum number of shares to be issued is used to determine the number of ordinary shares (DAS 340.216a).

In the case of options, all dilutive options are included when determining the number of ordinary shares. Options result in dilution only if the shares are issued at a price below fair value, where fair value is set at the average stock price of the ordinary shares outstanding in a specified period (DAS 340.217).

The number of dilutive shares is calculated as follows:

Number of dilutive shares = number of shares issued if no dilution would occur minus actual number of shares issued under options, where:

number of shares issued if no dilution would occur = receipts for shares issued under options divided by fair value per ordinary share.

Potential ordinary shares are considered dilutive only if and to the extent that conversion into ordinary shares would result in lower profit per ordinary share (DAS 340.221). In this way, the aim is to provide insight into earnings per share once all equity-related liabilities not yet reflected in dividends or the number of shares have been recognised.

Example: Diluted earnings per share in case of share options

The following data are provided:

	Amount	Quantity	Amount
Net profit after tax	12		
Weighted average number of shares in the period		50	
Average fair value per ordinary share in the period			0.24
Number of shares on which an option has been granted		20	
Exercise price options in the year			0.12

The diluted earnings per share are calculated as follows:

	Amount	Quantity	Amount	Explanation
Net profit after tax	12			
Weighted average number of shares in the period		50		
Therefore, earnings per share			0.24	(= 12 / 50)
Number of shares on which an option has been granted		20		
Number of shares if issued at fair value		(10)		(= 12 / 24 x 20)
Number of dilutive shares		10		(= 20 - 10)
Adjusted number of shares*		60		(= 50 + 10)
Diluted earnings per share			0.20	(= 12 / 60)

* This refers to the weighted average of ordinary shares and dilutive shares.

Subsequent events and comparative figures
Changes in the number of ordinary or potential ordinary shares outstanding after the reporting date but before the date of the financial statements are recognised retrospectively; this fact is disclosed (DAS 340.301).

Transactions with (potential) ordinary shares after the reporting date are disclosed if required for insight (DAS 340.303).

Comparative figures are adjusted retrospectively for changes in the numbers of ordinary shares with no equity effect. For effects of correction of material errors, changes in accounting policies and pooling of interests, comparative figures and multi-annual overviews are also adjusted (DAS 340.301).

Presentation
Both earnings per share and diluted earnings per share are presented, even if they are negative (DAS 340.402). They are disclosed on (the page of) the profit and loss account (DAS 340.401). In the notes, the numerator and denominator of the calculation are disclosed, as well as the reconciliation of these amounts to the net profit or loss for the period (DAS 340.501). If other information per share is also disclosed, the same number of shares is used as for the calculation of earnings per share (DAS 340.503).

It is recommended to explain the terms of financial instruments, that may result in dilution (DAS 340.502).

30.5 Discontinuance of operations

Introduction
Discontinuance of operations means that operations are not continued on a long-term basis (DAS 345.201). Operations that are not continued on a long-term basis are considered to be a component of an entity (DAS 345.201):

- which, as a result of a particular plan, the entity:
  - disposes of in its entirety or almost in its entirety, for example as a result of one sale transaction, a demerger or transfer of ownership; or
  - disposes of in parts, for example by selling individual assets or settling individual liability items of the component; or
  - liquidates or discontinues.
- which represents a significant distinct operation or provides goods or services in a significant distinct geographic area or to a significant distinct group of customers; and
- which can be distinguished both operationally and for financial reporting purposes.

If an operation meets these criteria, then additional information about the operation must be provided in the notes (see below).

Discontinuance
An operation is considered not to be continued on a long-term basis if the discontinuance has been achieved in the form of a contract to sell all or substantially all of the assets of the operation in question, or if there is a detailed plan approved and disclosed by the authorised bodies deciding on the discontinuance of an operation (DAS 345.301). This plan includes at least a description of the operations involved and the locations involved, the personnel and financial consequences as well as the period in which the plan will be implemented (DAS 345.302).

Not every asset disposal qualifies as a business discontinuance. Also other circumstances are considered to assess whether or not a business is discontinued. Conversely, a business discontinuance need not involve the disposal of assets, for example if these assets are used for the other operations (DAS 345.206 et seq.). Examples of asset disposals without discontinuing operations are:

- a company closes a factory, but the production made at that factory until then is moved to another site;
- a company has several sites but is forced to make cutbacks. It is therefore decided to close one site, the (intended) result being that some staff are laid off.

There may, of course, be cases of doubt. For example, in the case where two operations are mainly performed for the same customers, but controlled by different management and are placed under a single management from a certain point onwards due to reduced demand. From that point onwards, the merged operations will be reported internally. As a result of this downsizing, a site is subsequently closed and some staff are laid off. In assessing whether or not a form of business discontinuance exists, the decisive factors are whether both operations could still be reported internally (although this does not happen) and whether the operations are still separate (although they are carried out at one site). The degree of product diversity will play a role in this consideration.

It can be difficult to identify the moment of discontinuance, especially in case of a gradual disposal of activities. A restructuring, sale or any other event that does not meet the criteria set out in the definition is not considered a discontinuance or an operation that is not continued on a long-term basis (DAS 345.310).

Key individual operations
Operating segments as discussed in paragraph 30.6 will normally meet the criterion of being key individual operations. However, components of operating segments may also meet this criterion. For entities operating in a single segment, a significant group of products or services may also meet this criterion (DAS 345.209).

Distinction of operations
Although different operations are often grouped into legally independent entities, it is indeed possible that a legal entity carries out distinctly different operations in this context. It is also possible for the same operation to be carried out by several legal entities. A well-known example of the latter situation is the contracting company carrying out the same operations in several, especially geographically classified, companies. The decisive factor in recognising a

component is therefore the characteristics listed under b and c in the definition of 'an operation that is not continued on a long-term basis' (DAS 345.0).

A component can be distinguished operationally or for reporting purposes if (DAS 345.211):

- certain assets and liabilities are directly attributable to the component;
- certain revenues are directly attributable to the component; and
- more than half of certain costs are directly attributable to the component.

Direct attribution exists if assets, liabilities and revenues and costs are no longer used or disappear when a component is disposed of or otherwise discontinued (DAS 345.212).

Interest and other financing costs are attributable to a component only if the interest-bearing debt is directly attributable to the relevant component (DAS 345.212).

Presentation and disclosure
In the financial year in which an operation is discontinued, the following information is included in the notes (DAS 345.304):

- a description of the discontinued operation;
- the operating segment in which this operation is reported;
- the time and the nature of the initiatial event;
- the time when or the period in which the discontinuation will be completed (to the extent known or to be determined);
- the carrying amounts of disappearing assets and liabilities;
- the revenues, costs and profit or loss before and after tax attributable to the relevant component; and
- the cash flows of this component (from operating, investing and financing activities).

If assets and liabilities are disposed of as part of a discontinuance, the following is disclosed (DAS 345.307):

- the profit or loss before and after tax obtained from the disposal of the assets and liabilities;
- the total net disposal proceeds after deducting costs to be incurred relating to the assets and liabilities disposed of, for which a firm commitment has been made, as well as the expected timing of the receipt of the proceeds; and
- the total carrying amount of the relevant assets and liabilities.

The achieved profit or loss before tax as a result of the discontinuance is disclosed separately in the notes to the profit and loss account. Separate disclosure of revenues and cash flows is recommended. Comparative figures should be adjusted accordingly (DAS 345.401 and 404).

If several operations are discontinued in a financial year, the information referred to above is provided for each discontinued operation (DAS 345.309).

If the initial event (discontinuance) occurs after the reporting date but before the preparation of the financial statements, the relevant information is also included in the notes (DAS 345.306). This information is updated in subsequent financial statements until the financial year of settlement. If a plan changes, this fact and its consequences are disclosed (DAS 345.308).

Interim reports also disclose significant developments from the last financial statements with respect to the discontinuance (DAS 345.405).

A discontinuance is settled if the plan has been (almost) fully implemented or terminated. Incidentally, any buyer need not have made payment (in full) (DAS 345.308).

30.6 Segmented information

Introduction
Paragraph 26.9 has already addressed the statutory regulations on segmentation of revenue as they apply to all entities subject to the provisions of Title 9 of Book 2 NCC.

In addition, DAS 350 'Segmented information' includes recommendations in case an entity chooses to include additional segmented information in the notes. This standard recommends deriving segmented information from the internal information presented to the management board (DAS 350.301). In doing so, the Dutch Accounting Standards Board aligns with the approach in IFRS 8. DAS 350 includes as firm statement (in bold) only that the breakdown of net revenue as required by Title 9 of Book 2 NCC must be reconciled with the profit and loss account. Otherwise, only recommendations are made.

DAS 350 distinguishes between segmented information required by law and additional segmented information. The information required by law concerns no more than the breakdown of net revenue by the various industries and geographical areas in which it was achieved, as required by Article 2:380 NCC. Of course, only if the company also operates in different industries and geographical areas. Medium-sized and small entities are exempt from this.

If a legal entity wishes to (voluntarily) include additional segmented information in the financial statements, it is recommended (note: not required) to do so according to the provisions of DAS 350 (DAS 350.103). If the annual accounts include consolidated financial statements, the segmented information is provided on a consolidated basis (DAS 350.104). DAS 350 deals successively with:

- the basis from which the additional segmented information is derived (the management approach);
- the identification of operating segments;
- the identification of reportable segments; and
- the information provided on each reportable segment.

The basis from which the additional segmented information is derived
Additional segmented information is derived from the internal information submitted to an entity's management board. The way in which the management board manages the operations internally is therefore the guiding principle for the external information to be provided (DAS 350.301).

The accounting principles used in the internal information may differ from those used in the financial statements. As a result, the figures included in the financial statements under segmented information may also differ from the figures on the balance sheet and profit and loss account. The nature of the differences in accounting principles should be explained, as well as a numerical reconciliation for some key ratios (such as net revenue, operating profit and total assets) (DAS 350.315 and 316).

The identification of operating segments and reportable segments
An operating segment is defined as an operation of an entity that can generate revenues and incur expenses for which separate financial information is available and the profit or loss of which is regularly reviewed by the management board for the purpose of making decisions (DAS 350.304). Similar operating segments can be merged. Whether an operating segment qualifies as a reportable segment depends primarily on the size of that segment. The quantitative threshold is 10% or more of (DAS 350.308):

- the total revenue of the segments; or
- the highest absolute amount of the combined profit or loss of all segments with a profit or with a loss; or
- the total assets of the segments.

However, the management board may also designate an operating segment as a reportable segment based on qualitative considerations. Total net revenue of separately reportable segments must be at least 75% of the entity's total net revenue (DAS 350.310). If the 75% condition is met, the remaining operating segments are combined into 'other segments' (DAS 350.311).

The annex to this chapter includes a diagram of the choice structure for determining reportable segments.

Information provided on each reportable segment
An entity is recommended to explain how the segments have been identified (based on products and services, geography, applicable regulations) and what products and services each reportable segment contains (DAS 350.313).

To the extent that can be derived from the available management information, an entity provides information on profit or loss, on assets and on provisions and liabilities for each reportable segment. An entity is in principle free to determine what information is specifically provided. Among other things, this will be able to include net revenue, depreciation and amortisation, operating profit, investments, carrying amounts of assets and provisions and liabilities as well as exceptional items (DAS 350.314).

Any differences from the financial statements are disclosed as already described above. Also, if, compared to the previous year, a different composition of reportable segments arises, this must be disclosed and the comparative figures are adjusted (unless, of course, that information is not available) (DAS 350.317).

30.7 Disclosure of audit fees

Introduction
Pursuant to Article 2:382a NCC, large entities are required to disclose in the notes to the financial statements the audit firm fees charged to the entity during the financial year. The fees should be split into the following categories:

- audit of the financial statements;
- other audit engagements;
- tax advisory services; and
- other non-audit services.

The starting point of this statutory provision is that the statement serves to assess the independence of the external auditor who audited the financial statements.

Disclosure of the fees may, subject to conditions, be omitted from financial statements of entities that are consolidated. This exemption applies to entities meeting the following conditions (Article 2:381(3) NCC):

- the financial data of the entity are included in consolidated financial statements to which, under applicable law, the Regulation of the European Parliament and of the Council on the application of international accounting standards (IFRS Regulation) or the EU Accounting Directive of 26 June 2013 (Directive 2013/34/EU) applies; and
- the fees referred to in Article 2:382a(1) NCC are disclosed in the notes to these consolidated financial statements.

The condition that EU law must apply to the parent consolidated financial statements is similar to that of the group exemption of Article 2:403(1c) NCC. This means, for example, that subsidiaries of non-EU companies (United States, Canada, Japan) cannot use this exemption. Also for subsidiaries of companies from the United Kingdom of Great Britain and Northern Ireland (UK) whose consolidated UK financial statements are prepared on or after 1 January 2021, it is no longer possible - due to Brexit - to use this exemption on the basis of those consolidated UK financial statements.

Recognition and disclosure of audit fees
In practice, audit fees are charged to profit or loss using two different methods. The accounting method used is relevant to the disclosure of audit fees. After all, the fees charged to profit or loss in the financial year must be disclosed.

Under the first accounting method, all audit fees incurred to audit financial statements for a financial year are allocated to the financial year to which the financial statements apply. An item of audit fees payable is then recognised for the (audit) work to be carried out after the financial year. The second accounting method is based on the definition of liabilities and is consistent with the services performed during the reporting period. Usually, the company has not yet received all (audit) services at the end of the financial year, so the item of outstanding audit fees does not formally meet the definition of a liability. The item of outstanding audit fees is not recognised in the financial statements for this reason. This second accounting method therefore allocates the fees to the financial year in which the work was performed.

The Dutch Accounting Standards Board has noted that in practice there is a strong preference for the first accounting method. It therefore recommends that the total fees to be disclosed in the notes should be based on that first accounting method, regardless of whether the work was already performed by the external auditor and the audit firm during that financial year (DAS 390.301a). However, it remains permissible to base the total fees to be disclosed in the notes (systematically) on the second accounting method. The method of disclosing the total fees for the audit of the financial statements should be stated (DAS 390.301a).

The fees of which organisational units should be disclosed?
The audit firm mentioned in Article 1 of the Audit Firms Supervision Act refers exclusively to the audit firm charged with the statutory audit of financial statements. Based on the wording of Article 2:382a NCC, the fees of other organisational units (e.g. tax advisers or management consultants) do not have to be disclosed if those organisational units are not part of the organisational unit conducting the statutory audit.

The same can be said for fees charged by affiliated foreign auditors who are part of the network but not of the Dutch organisational unit carrying out the statutory audit.

According to the Dutch Accounting Standards Board, the assessment of the external auditor's independence benefits from including the fees of the audit firm's network. Therefore, the Board strongly recommends also disclosing the fees of the (international) network to which the external auditor belongs (DAS 390.301). In addition, it is recommended - if applicable - to disclose that a material part of the subsidiaries included in the consolidation is audited by another external auditor, stating their fees (DAS 390.302).

In NIVRA Guide 1 'Disclosure of audit fees in financial statements' of 13 February 2009, a preference was expressed to disclose both the fees of the organisational unit in charge of the statutory audit and the fees of the entire network to which the audit firm belongs. If this information is disaggregated and provided with comparative figures, the view included in the NIVRA Guide on the one hand complies with the literal text of the law and on the other hand provides information that is relevant for stakeholders to form a view of the total package of services rendered by the audit firm and its affiliated network.

Example: Disclosure of audit fees according to the preference expressed in the NIVRA Guide

20XX	**X Auditors**	**Other X network**	**Total X network**
Audit of the financial statements			
Other audit engagements			
Tax advisory services			
Other non-audit services			
Total			
20XX - 1	**X Auditors**	**Other X network**	**Total X network**
Audit of the financial statements			
Other audit engagements			
Tax advisory services			
Other non-audit services			
Total			

Does Article 2:382a(2) NCC pertain to the company-only or consolidated financial statements?
Article 2:382a(2) NCC stipulates that fees charged in the financial year to subsidiaries an entity has and to other companies whose financial data it consolidates must be included in the entity's statement. According to the Dutch Accounting Standards Board, this means that fees charged to these companies during the financial year are included in the statement (DAS 390.302). The Dutch Accounting Standards Board recommends including the statement in the notes to the consolidated financial statements (DAS 390.302). However, the question is how this relates to Article 2:410(1) NCC, which explicitly provides that Article 2:382a NCC does not apply to the consolidated financial statements.

Based on the legal text, we believe it should be concluded that under Article 2:382a(2) NCC, the statement of the fees is included in the notes to the company-only financial statements, but that these should include the 'consolidated fees'. Article 2:382a(2) NCC states that if an entity has subsidiaries or consolidates the financial data of other companies, the fees charged 'at their expense' (i.e. at the expense of the subsidiaries and other companies included in the consolidation) are included in 'the statement', where 'the statement', in our view, refers to 'being stated' as mentioned in paragraph 1. 'The statement' in the company-only financial statements of a reporting entity includes the fees charged to the subsidiaries that the entity has (whether consolidated or not) and to other companies that are consolidated. These other companies are not 'consolidated' in the company-only financial statements of the reporting entity, but in our view this does not alter this provision in paragraph 2.

One can rightly ask whether the legislator's choice to cite Article 2:382a NCC in Article 2:410 NCC was a clever and correct one. Article 49(2) of Directive 2006/43/EC, which added a point (no. 16) to Article 34 of the Seventh EC Directive, seems to assume - given the term 'separately' - that these fees should (also) be stated in the consolidated financial statements. Apparently, in spite of this provision of the directive, the Dutch legislator has chosen that a 'one-off' disclosure of these fees is sufficient, i.e. in the company-only financial statements, and that these fees need not (also) be stated the consolidated financial statements. This creates in our country the - perhaps at first sight somewhat strange - notion of 'consolidated fees' being included in an entity's company-only rather than consolidated financial statements.

May the disclosure be omitted for reasons of immateriality?
Statutory disclosures may generally be omitted if disclosure is immaterial to the legally required insight. However, that statutory provision in Article 2:363(3) NCC includes a number of exceptions. For example, the average number of employees and (for large and medium-sized entities) the remuneration of management board and supervisory board members must always be disclosed. The legislator seems to have failed to add an exception to Article 2:363(3) NCC for the disclosure of auditor's fees. Strictly speaking, the disclosure may therefore be omitted on grounds of immateriality to the legally required insight. However, this does not seem compatible with the purpose of mandatory disclosure of auditor's fees. There is also no such exception in the EC directive on which that disclosure requirement is based.

30.8 Off-balance-sheet arrangements

Introduction
Entities must disclose off-balance sheet arrangements. This is regulated by Article 2:381(2) NCC which reads as follows:

> 'The nature, business purpose and financial effects of off-balance-sheet arrangements of the entity must also be disclosed if the risks or benefits arising from such arrangements are material and to the extent that the publication of such risks or benefits is necessary for assessing the entity's financial position.'

The information is included in both the company-only and consolidated financial statements as it is provided from the company-only and consolidated perspective, respectively.

Information to be provided
The Explanatory Memorandum states as follows on the statutory requirements: 'Information on off-balance sheet arrangements should be included in the notes to the financial statements. This is information about the nature, business purpose and financial effects of transactions and contracts of an entity that are not reflected on the balance sheet, but which affect the entity's financial position because they may involve risks or benefits for the entity. This information must be disclosed if these risks or benefits are material and to the extent that their publication is necessary for assessing the entity's financial position. These off-balance-sheet arrangements may include any transaction or contract between entities, even if they are unincorporated, that is not recognised on the balance-sheet. Such arrangements may relate to the establishment use of one or more special-purpose entities and offshore activities.

Examples cited in the Explanatory Memorandum include (in addition to the structures mentioned above):

- risk and profit-sharing arrangements or liabilities arising from a contract such as debt factoring;
- combined purchase and repurchase agreements;
- arrangements regarding consignment of shares;
- 'take or pay' arrangements;
- securitisation arranged through separate entities and unincorporated entities;
- pledged assets;

- operating lease arrangements; and
- outsourcing.

If disclosure under the law is applicable, the following aspects may be relevant for disclosure, depending on the situation and arrangement (DAS 390.206):

- nature of the arrangement;
- duration of the arrangement;
- key features;
- the extent of possible financial advantages and disadvantages and the circumstances on which they depend;
- to what extent the counterparty qualifies as a related party;
- the financial agreements made.

30.9 Rendering of services under concessions

If services are rendered under concessions, DAS 390 requires additional disclosures to be included in the financial statements of the concessionaire and in the financial statements of the grantor. For this, see paragraph 35.6.

30.10 Notes to judgements, estimates and uncertainties

In applying the accounting principles and rules for preparing financial statements, the management of an entity makes various judgements and estimates that may be essential to the amounts recognised in the financial statements. If necessary in order to provide the insight required by Article 2:362(1) NCC, the entity will disclose the nature of these judgements and estimates including the associated assumptions (DAS 110.129).

Examples of judgements and estimates that may have a significant effect on the amounts recognised in the financial statements are (DAS 110.129):

- determining whether there is a consolidation requirement;
- determining whether a company falls within the consolidation scope;
- determining whether there is joint control over another company;
- determining whether the conditions for recognising internally manufactured intangible fixed assets are met;
- determining whether a lease classifies as a finance or operating lease;
- determining whether or not amounts are received for one's own account;
- determining the best estimate of provisions arising from claims, disputes and litigation;
- determining the extent of an impairment; and
- determining the likelihood of agreement by tax authorities with an uncertain tax position, as well as its scope.

A legal entity must explain such judgements and estimates if they are not evident (DAS 110.129).

In addition to judgements and estimates, uncertainties can have a significant impact on the amounts recognised in the financial statements. For example, the collectability of bad debts, the probable useful life of tangible fixed assets and the number of claims that could arise under guarantee provided. Such uncertainties are taken into account by exercising prudence (see paragraph 2.4.2) and by disclosing their nature and extent (DAS 135.203). The Dutch Accounting Standards Board stresses that an entity must disclose the nature and extent of such uncertainties if this is necessary to provide the insight required by Article 2:362(1) NCC (DAS 135.203).

30.11 Key figures, key ratios and multi-annual overviews

Introduction
Key figures, key ratios and multi-annual overviews are often included to provide users with a brief overview of (developments in) the financial position and profit or loss, whether or not for a longer series of years.

A key figure means the numerical representation of a number important to the company. This includes alternative performance measures (APMs). Examples of APMs are: operating profit, cash earnings, profit or loss before non-recurring costs, profit or loss before interest, tax, depreciation and amortisation (EBITDA), net debt, organic growth or similar terms that are adjustments to items in the profit and loss account, balance sheet or cash flow statement.

A key ratio (also called ratio) means a number that represents a relationship between two numbers that is important to the company.

A multi-annual overview means the presentation over a series of usually five or more years of key figures and key ratios relating to components of the financial statements, whether summarised or not.

The annual accounts, where applicable, consist of:

- the financial statements (company-only and consolidated), including notes;
- the management board report;
- the supervisory board report;
- the Other information; and
- other information accompanying the financial statements, the management board report and the Other information: related information that is not formally part of the financial statements, the management board report or the Other information, such as key figures, key ratios and multi-annual overviews.

Use of key figures and key ratios
The key figures and key ratios in annual accounts can be distinguished into key figures and key ratios derived directly and not directly from the financial statements. Key figures and key ratios that cannot be directly derived from the financial statements or that are not specifically defined in law and regulations, should be clearly defined and explained (DAS 430.104). In particular, the definition, method of calculation and, as far as possible, a numerical reconciliation with items in the financial statements should be explained.

Key figures and key ratios that cannot be derived directly from the financial statements are not presented with more emphasis than key figures and key ratios that can be derived directly from the financial statements (DAS 430.106).

For each key figure and key ratio, comparative figures for the previous year are given (as much and as far as possible). In principle, calculations should be carried out in the same way throughout the years. If different key figures and key ratios are given in the current reporting period or if the method of calculation has changed, the comparative figures should be adjusted. If this is not practically possible, it should be disclosed. In addition, the reason for changes in the key figures and key ratios chosen and changes in the method of calculation should be explained (DAS 430.105). In general, key figures and key ratios should preferably be derived from the consolidated financial statements wherever possible (DAS 430.107).

Use of multi-annual overviews
For listed companies, it is common practice to include multi-annual overviews. For unlisted companies, recognition is recommended (DAS 430.108).

30.12 Exemptions for medium-sized and small entities

For all specific parts of the notes and other information, small entities need only need include the information required by law and may consider disclosing additional information ('over and above the legal minimum') in the notes.

In addition, the exemptions specifically mentioned below apply:

Notes
Medium-sized and small entities are exempt from the obligation to relate the various balance sheet items, items of the profit and loss account and items of the cash flow statement, if any, to the corresponding parts of the notes by reference. Medium-sized entities are recommended to include such a reference (DAS 300.104).

Related parties
Medium-sized private limited liability entities are exempt from the disclosure requirements regarding related party transactions.

For a medium-sized public limited liability entity, disclosure is limited to only transactions directly or indirectly entered into between the company and its principal shareholders and between the company and its members of the management board and of the supervisory board.

Discontinuance of operations
Regarding the discontinuance of operations, there are simplified disclosure requirements for medium-sized entities (DAS 345.304).

Segmented information
Medium-sized and small entities are exempt from the statutory requirements regarding segmentation of net revenue (Article 2:397(4) and 396(5) NCC, respectively).

Audit fees
Medium-sized and small entities are exempt from providing information on audit fees (pursuant to Article 2:397(4) and Article 2:396(5) NCC, respectively).

Off-balance-sheet arrangements
Small entities are exempt from disclosure of off-balance-sheet arrangements.

Medium-sized entities are only required to provide information on the nature and business purpose of off-balance-sheet arrangements. They are exempt from providing information on the financial effects of these arrangements (Article 2:397(6) NCC).

30.13 Significant differences from IFRS

Related parties
Under IAS 24 'Related Party Disclosures', related party transactions must be disclosed. IAS 24 does not distinguish between transactions entered into under normal market conditions and those not. NL GAAP requires large entities to disclose material transactions entered into by an entity with related parties if these transactions did not take place under normal market conditions.

In IAS 24, simplified disclosure requirements apply to transactions with related parties controlled by the government (government related parties). NL GAAP has no such provisions.

Earnings per share
Under IAS 33 'Earnings per Share', the earnings per share and diluted earnings per share must be disclosed in the statement of comprehensive income. Under DAS 340 'Earnings per share', this can be disclosed as part of the notes. The requirements for calculating the earnings per share and the diluted earnings per share are equivalent.

Listed entities are required to apply IAS 33. Non-listed entities that apply IFRS and that (voluntarily) choose to disclose the earnings per share are required to comply with the provisions of IAS 33. Companies that apply NL GAAP and that (voluntarily) choose to disclose the earnings per share are required to comply with the provisions of DAS 340.

Held for sale
IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' requires that assets and groups of assets and liabilities (disposal groups), the disposal of which is highly probable, be presented on the balance sheet as 'held for sale'. This presentation takes place from the moment the held-for-sale criteria are met. IFRS 5 requires assets held for sale and those belonging to a disposal group held for sale to be presented in a separate item on the balance sheet. Liabilities belonging to a disposal group held for sale are presented in a separate item on the credit side of the balance sheet. The comparative figures are not restated. Valuation of assets held for sale (and disposal groups held for sale) is at the lower of carrying amount and fair value less selling costs. Assets classified as held for sale, or belonging to a disposal group classified as held for sale, are not depreciated. This is based on the notion that these assets will no longer be recovered through continued use for the purpose of operating activities but from a liquidation (sale) expected within 12 months.

NL GAAP does not include presentation and measurement requirements for assets and disposal groups held for sale. The Decree on annual accounts format does not permit such a method of presentation on the balance sheet.

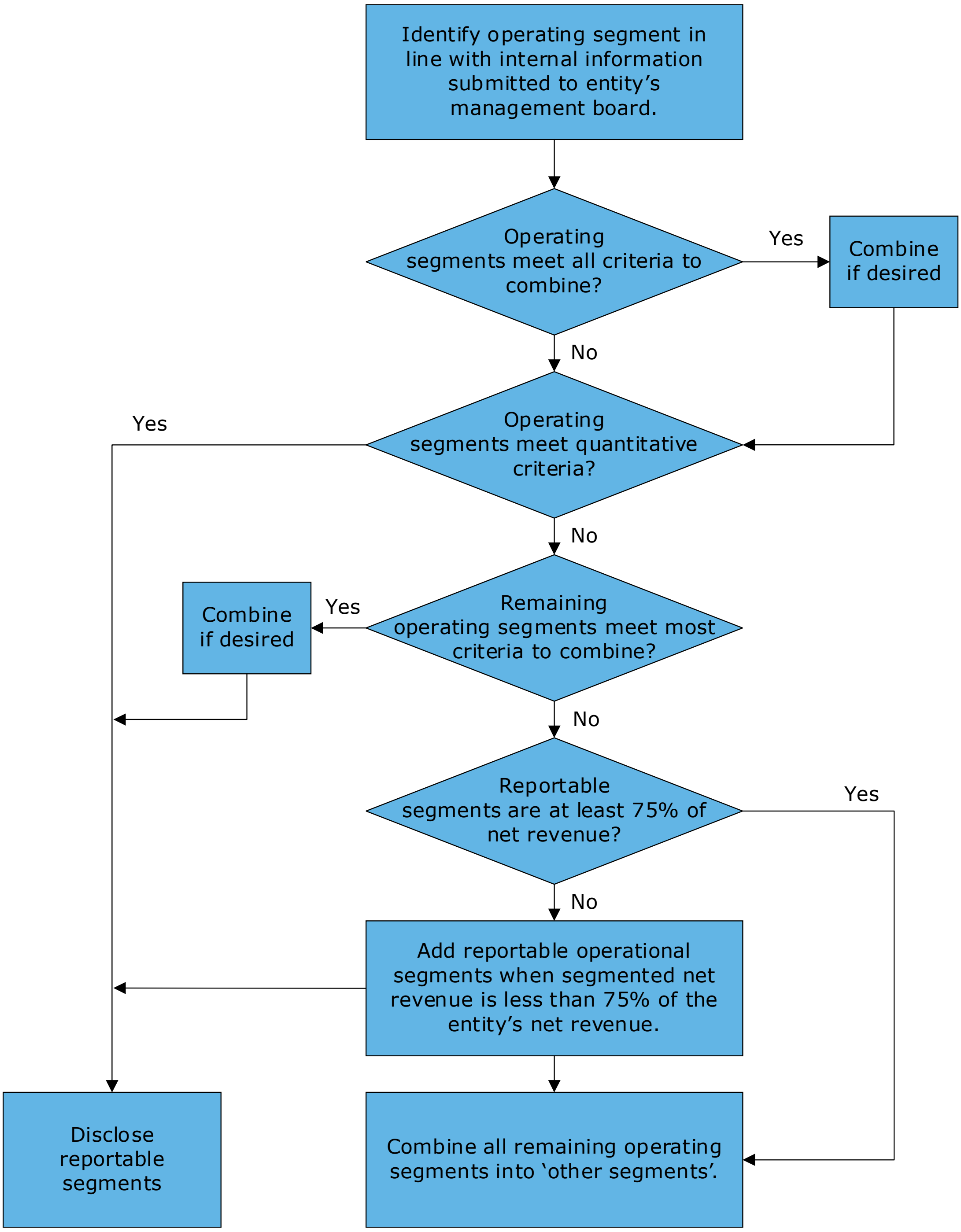
Discontinuance of operations
IFRS 5 states that the amount (the balance of revenues and expenses) attributable to operations that are or have been discontinued (discontinued operations) should be presented as a separate item in the profit and loss account.

NL GAAP has no such requirement. Incidentally, the Decree on annual accounts format does not allow such a method of presentation in the profit and loss account. Under NL GAAP, the profit or loss of a business operation that is being or has been discontinued must be disclosed in the notes.discontinued must be disclosed in the notes.

Segmented information
The segmented information provisions included in DAS 350 ‘Segmented information’ are based on IFRS 8 'Operating Segments', albeit DAS 350 is less prescriptive and less detailed.

Listed entities are required to apply IFRS 8. Non-listed entities that apply IFRS can voluntarily choose to apply IFRS 8. Entities that apply NL GAAP are legally required to provide segmented information about the net revenue. In addition, DAS 350 includes recommendations for entities that choose to provide additional segmented information.

Annex 1. Diagram of choice structure for compilation reportable segments (extracted from DAS 350)



31 Mergers and acquisitions

31.1 Introduction and scope

In practice, mergers and acquisitions refer to the merging of separate companies into a single economic entity. The term 'merger' is also used in some cases when there is an acquisition within the meaning of this chapter. The term used often relates to legal or tax aspects of the way in which the acquisition is effected (share merger, corporate merger, legal merger).

This chapter applies to all forms of mergers and acquisitions involving the acquisition of an integrated set of activities, assets and/or liabilities capable of generating revenues. If this is not the case, the acquirer recognises the acquired identifiable assets and/or liabilities in accordance with the relevant chapters for acquiring assets and assuming liabilities respectively. The acquisition cost is then allocated to the acquired identifiable assets and/or liabilities on the basis of their relative fair value on the acquisition date. No goodwill arises as a result of such transaction or event (DAS 216.101).

Example: Qualification of merger/acquisition or acquisition of identifiable assets

A, a private limited liability entity, takes over B (also a private limited liability entity) for a price of 15 million. B's only asset is a patent. A recognised 15 million as goodwill. Is that correct?

This does not involve an integrated set of activities, assets and/or liabilities as described above. This transaction concerns the purchase of an individual asset and falls within the scope of DAS 210 'Intangible fixed assets'. A cost of 15 million should be allocated to the patent. No goodwill can be recognised.

In many cases it is immediately clear whether an integrated set of activities, assets and/or liabilities has been acquired that is capable of generating income, but in some cases a higher degree of judgement is required.

Example: Recognition of acquisition versus recognition of purchase of assets and liabilities

A, a private limited liability entity, buys 100% of the shares of B (also a private limited liability entity). The purchase price is 13,100 and the additional transaction costs are 200, making a total of 13,300. B's activities consist of the operation of a vessel. On the acquisition date, B's balance sheet consists of:

Tangible fixed assets (vessel)	8,000	
Inventory	500	
Cash	1,000	
Equity		9,500

The fair value of the vessel is 12,000 on the acquisition date. The fair value of the other identifiable assets and liabilities is equal to the carrying amount. The nominal tax rate is 25%.

If A recognises the acquisition of the shares in B as an acquisition, the journal entry for the recognition in A's consolidated financial statements is as follows:

Goodwill	800	
Tangible fixed assets (vessel)	12,000	
Inventory	500	
Cash	1,000	
Provision for deferred taxes (= 25% of (12,000 – 8,000))		1,000
Bank		13,300

If A recognises the acquisition of the shares in B as the purchase of assets, the journal entry for the recognition in A's consolidated financial statements is as follows:		
Tangible fixed assets (vessel)	11,808	
Inventory	492	
Cash	1,000	
Bank		13,300

The purchase price was allocated as follows:	
Purchase price (including transaction costs)	13,300
Less: Cash (under DAS 290 at fair value)	1,000
Amount remaining for purchased assets	12,300
Purchased assets:	
Tangible fixed assets based on relative fair value (= 12,300 * (12,000 / (12,000 + 500)))	11,808
Inventory based on relative fair value (= 12,300 * (500 / (12,000 + 500)))	492
	12,300

Forms of mergers and acquisitions can be share transactions, asset/liability transactions or legal mergers. If an acquisition is effected through an asset/liability transaction, the acquirer recognises the acquisition in both its company-only and consolidated financial statements as described in this chapter. This chapter does not deal with the recognition of:

- mergers and acquisitions in the company-only balance sheet of the acquirer, except for the asset/liability transaction referred to above. See Chapter 9, which describes the measurement of participating interests;
- equity interests in joint ventures. See Chapter 34 on this subject; and
- the recognition of minority shareholdings in the consolidated financial statements. See Chapter 33 on this subject.

31.2 Nature of mergers and acquisitions

For the purpose of recognition in the financial statements, this chapter distinguishes between acquisitions and pooling of interests. There is an essential difference between the recognition of an acquisition and a pooling of interests. This difference is reflected in the financial statements by the use of different recognition methods. To determine whether there is an acquisition or a pooling of interests, the factors described in the following paragraphs must be viewed together.

31.2.1 Acquisitions

An acquisition concerns a transaction in which the acquirer obtains control of the net assets, i.e. the assets and liabilities, and the activities of the acquiree (DAS 216.0). Control is the power to govern the operating and financial policies of an entity in order to obtain economic benefits from its activities (DAS 216.107).

Almost all mergers and acquisitions qualify as an acquisition. It is presumed that control is acquired when one of the parties obtains actual decisive influence of the other party, unless, in exceptional cases, it can be clearly demonstrated that control is nevertheless not acquired. Even if neither party acquires a controlling interest in the other party, it may be possible to identify an acquirer as such if, as a result of the merger or acquisition, one of the parties (DAS 216.107):

- can exercise more than half of the voting rights in the other party through a shareholders' agreement;
- obtains, by means of articles of association or an agreement, control of the operating and financial policies of the other party;
- obtains the right to dismiss the majority of the other party's management board members or supervisory board members; or
- can exercise a casting vote in the management board meetings or meetings of the supervisory board of the other party.

Although it is sometimes not easy to identify an acquirer as such, there are usually clues that allow identification. Examples include (DAS 216.108):

- the fair value of one of the parties is significantly higher than that of the other party;
- one of the parties acquires the shares in the other party against payment in cash; or
- the management of one of the parties has a decisive vote in the selection of the management team of the new combination.

31.2.2 Pooling of interests

A pooling of interests concerns a merger of companies in which the shareholders of the parties involved combine control of the entire or almost the entire net assets and the entire or almost the entire operation in order to achieve a sustainable distribution of risks and income of the merged entity, such that none of the parties can be regarded as acquirer (DAS 216.0). Only in exceptional cases will there be no acquisition. This is the case if more or less equal parties enter into a form of cooperation involving a pooling of interests (DAS 216.110). There may be a pooling of interests if the following circumstances arise (DAS 216.111):

- there are no acquiring and acquired parties in the transaction (this implies that the fair values of each of the parties are not materially different);
- the entire or almost the entire net assets and the entire or almost the entire operations of two or more entities are combined;
- the transaction consists of an exchange of shares, in which all or virtually all ordinary voting shares are part of the performance and consideration;
- the transaction aims at a sustainable joint sharing of risks and income; and
- the shareholders of each party will retain in the combined entity substantially the same voting rights and interests with respect to each other as they had in the constituent parts prior to the merger.

31.3 Recognition of acquisitions (purchase accounting)

An entity shall account for an acquisition by applying the purchase accounting method (DAS 216.201). This method is described in this paragraph.

It is possible that the acquirer and the acquiree agree on transactions as part of an acquisition, but which transactions are not part of the acquisition. Consider settling transactions that are part of an existing relationship between the acquirer and the acquiree. Another example concerns compensation to employees or former owners of the acquiree for future services. The Dutch Accounting Standards Board stipulates that the acquirer assesses on the basis of the economic reality whether such transactions should be recognised as separate transactions or as part of the acquisition. This can have a significant impact on the recognition of those individual transactions and on the amount of the goodwill.

Example: Remuneration that is not part of the acquisition

Private limited liability entity A acquires the activities and associated assets and liabilities of private limited liability entity B. The selling shareholder will remain the director of B. The purchase agreement stipulates that in addition to a cash consideration of 1,000,000, A will also pay an amount of 100,000 one year after the acquisition date if the profit of B for that year is at least 100,000 higher than the budgeted profit for that year, provided that the selling shareholder is still employed as a director of the company.

The additional amount of 100,000 is a fee for future services provided by the director and should therefore not be recognised as part of the acquisition cost. This amount is a remuneration for the work performed by the director and must be recognised as such, i.e. as salary costs during the year in question. The additional amount of 100,000 is therefore not part of the acquisition cost paid by A for the acquisition of B. This amount of 100,000 is therefore not taken into account in determining the amount of the goodwill.

31.3.1 Determination of acquisition date

From the acquisition date, the acquirer must include the income and expenses of the acquiree in its profit and loss account, and recognise the identifiable assets and liabilities of the acquiree and any (negative) goodwill arising on the acquisition in its balance sheet (DAS 216.202). The acquisition date is the date on which control of the acquiree's net assets and activities effectively transfers to the acquirer. Control in this context is the ability to exercise decisive influence over the operating and financial policies of an entity in order to obtain economic benefits from its activities (DAS 216.107). Control is not deemed to have been transferred to the acquirer as long as all necessary conditions to safeguard the interests of the parties concerned have not been met. This does not necessarily mean that a transaction must be legally completed in full before control is deemed to have been effectively transferred. Acquiring control will often coincide with the actual holding of the acquiree for one's own risk and expense, as can be seen, for example, from agreements about the transaction price. It must therefore be assessed from when the acquirer can exercise decisive influence in the acquiree and has become entitled to the economic benefits of the entity in connection therewith. For practical reasons, for example due to the availability of financial data, it is acceptable to start recognising the income and expenses at a time other than the time of acquisition, provided this does not have a material impact on equity and profit or loss.

Example: Acquisition date (1)

A takes over B. The acquisition must be approved by the competition authority before the acquisition can be effected. Recognition of the acquisition can only take place once control has actually been transferred. In Europe, the approval of the competition authorities is usually required before control can be transferred by law. The acquisition can then only be recognised after approval from these authorities and the actual transfer of control.

Profit or loss with retroactive effect at the risk and expense of the acquirer

In practice, it often happens that an acquisition contract states that the profit or loss will be for the risk and account of the acquirer with retroactive effect. However, the acquirer can only recognise this profit or loss from the moment it has actually acquired control.

Example: Acquisition date (2)

Company A takes over Company B. Over time, the following events have occurred:

- the talks started on 1 February of any year;
- the letter of intent was signed on 1 June of that year. This letter of intent stipulates that A must grant approval for major (dis)investments and share transactions; and
- the acquisition was finally ratified in an acquisition agreement dated 1 October. This agreement states that the assets, liabilities and profit or loss are for the account and risk of A from 1 January of that year, therefore with retroactive effect.

A can recognise B’s assets, liabilities, income and expenses once it has acquired control. In general, it will have acquired this control at the time of the formal conclusion of the acquisition agreement. Only then can A exercise its control. A’s powers laid down in the letter of intent should be seen as a protection of its (future) investment. A has not yet acquired control of B. The formal legal provisions included in the acquisition agreement with regard to entitlement to the profit or loss from 1 January are not complied with from a business-economics point of view, because A can only recognise these income and expenses from the moment that it has actually acquired control of B (this profit or loss is considered part of the purchase price). The acquisition date can sometimes be earlier than 1 October, if it is clear that the acquirer has acquired decisive influence over the acquiree from that earlier date and is entitled to the economic benefits of the acquiree. This should be assessed on the basis of the contract, the actual course of events and through an analysis of the purchase price.

As can be seen from the previous example, consolidation of the income and expenses with retroactive effect from 1 January of the acquisition year is not permitted solely on the basis of a wording in the acquisition contract. This is also understandable, because in the case of an acquisition during the year, the profit or loss of the current financial year is implicitly or explicitly taken into account in the purchase price. If the income and expenses of the current year are nevertheless included in the consolidation, this does not give a true and fair view of the purchased company's equity and profit or loss. This can be made clear with the following numerical example.

Example: Recognition of acquisition

Suppose a company to be acquired has a net asset value of 5,000 on 1 January. The profit for that year amounts to 1,000, of which 600 over the first half of the year. We assume that the fair value of the identifiable assets is equal to the net asset value and also increases by profit of 600 over the first half of the year. The company was acquired on 1 July for a price of 10,000. As of that date, the old management board stepped down and was succeeded by a new management board appointed by the acquirer. The acquisition agreement contains the more or less standard text that the profit or loss is deemed to be for the acquirer’s account as of 1 January.

The goodwill is amortised over ten years. There seem to be the following two possible methods of recognition of this acquisition:

- recognition as at 1 January; or
- recognition as at 1 July.

	Date of recognition of acquisition	
	1 January	**1 July**
Net asset value as at 1 January (based on fair values)	5,000	5,000
Profit in first half year	N/A	600
Total	5,000	5,600
Purchase price paid	10,000	10,000
Goodwill paid	5,000	4,400
Profit generated by participating interest for financial year	1,000	400
Goodwill amortization (one full year or six months respectively)	500	220
Balance of profit generated by participating interest to be recognised by the acquirer	500	180

It will be clear that this has a major impact on equity and profit or loss. This means that the recognition of the acquisition as at 1 January, based on the literal text of the acquisition agreement, must be regarded as incorrect.

As an alternative, it is possible to include a recalculated profit and loss account in which the newly acquired participating interest is recognised for the entire year (pro forma statement) as notes to the financial statements for the purpose of the insight. If such a pro forma statement is added, it takes into account possible changes in amortisation charges, financing charges and taxes that would have occurred if the acquisition had already taken place at the beginning of the financial year.

31.3.2 Determination of the acquisition cost

The acquisition cost shall be determined on the acquisition date and consists of the amount or equivalent agreed to acquire the acquiree or the fair value, on the acquisition date, of the consideration provided by the acquirer in exchange for control of the assets and liabilities of the acquiree, plus any costs directly attributable to the acquisition (DAS 216.203). If payment of the purchase price is postponed, the acquisition cost is set at the present value of the purchase price to be paid at that time.

Payment in marketable assets

When determining the acquisition cost, marketable assets (e.g. shares and bonds) issued by the acquirer are measured at fair value, being the market price on the acquisition date, unless the market price is not a reliable indicator due to illiquidity or exaggerated price fluctuations. When the market price on a specific date is not a reliable indicator, price fluctuations for a reasonable period before and after the announcement of the acquisition are considered. When the market price is an unreliable indicator or when there is no listing, the fair value of the shares issued by the acquirer is estimated on the basis of the proportional interest in the fair value of the acquirer's business or on the basis of the proportional interest in the fair value of the acquired company. This depends on the answer to the question as to which value can be determined most reliably. If part of the consideration was paid in cash as an alternative to shares in the acquirer, this may also be an indication of the fair value of the shares offered (DAS 216.206).

Acquisition-related costs
The acquisition cost is increased by the acquirer's costs that are directly related to the acquisition. This includes the costs of registration and issue of shares as well as the costs of accountants, lawyers, valuers and other advisers for making the acquisition. The acquisition cost does not include general administrative costs (including the costs incurred by a department charged with administering acquisitions) and other costs not specifically attributable to an acquisition (DAS 216.207). The costs of arranging the financing of the acquisition should in principle be viewed separately from the acquisition itself. Additional costs in obtaining debt financing (for a proposed acquisition) must therefore be recognised as 'interest expenses and similar expenses' in accordance with DAS 273 (see Chapter 27). According to this principle, costs arising from a share issue to finance an acquisition should also not be recognised as part of the acquisition cost, but in accordance with DAS 240. The Dutch Accounting Standards Board expresses a preference for charging these costs directly to the share premium. It is recommended not to apply the legal possibility of capitalisation (DAS 210.103).

Uncertain acquisition cost
It is possible that the acquisition cost has not yet been fully determined on the acquisition date. This is the case if all or part of the price is made dependent on future events. For example, with an earn-out arrangement, in which part of the acquisition cost is determined by the future profit of the acquiree. Or, for example, with a stipulation that the price will be adjusted if the profit falls below a certain amount. Future events must be taken into account on the acquisition date to the extent that they are likely to occur and the amount can be measured reliably (DAS 216.239). An expected subsequent payment based on an earn-out arrangement must therefore already be recognised on the acquisition date, insofar as this can be reliably estimated. In the event of a subsequent change in the estimate, the resulting revision is recognised as an adjustment to the acquisition cost and goodwill (see paragraph 31.3.7).

Other payments to the acquiree
A company must assess whether the payment to the selling party contains any elements that are not part of the acquisition cost, but should be regarded as a payment for other transactions (whether implicit or not) (pursuant to DAS 115.107 and DAS 190.4). For example, if the acquirer and seller had already concluded a contractual agreement prior to the acquisition, the acquisition effectively terminates this agreement in an economic sense. Depending on the terms of the contractual agreement, its early termination may result in the payment of a lump sum. Although this lump sum payment has not been agreed in a legal sense, it can be regarded as a separate transaction in an economic sense. Such deemed lump sum payment is no payment for the assets and liabilities acquired from the acquiree and is therefore not part of the acquisition cost. DAS 216 does not explicitly deal with this theme.

In such cases, DAS 110.110 prescribes choosing a recognition method that provides relevant and reliable information that is consistent with the economic reality of the transaction.

31.3.3 Recognition of identifiable assets and liabilities

The entity must recognise the identifiable assets and liabilities of the acquiree on the acquisition date together with the provisions to be recognised as described below.

Identifiable
Identifiable means: clearly distinguishable from goodwill. An asset or liability can be clearly distinguished from goodwill if the asset is separable, i.e. if the entity can rent, sell, exchange or distribute the specific future economic benefits of the asset separately from the future economic benefits associated with other assets or liabilities in the same revenue-generating activity.

Incidentally, separability is not a separate condition for identifiability if an entity is able to identify an asset in another way. For example, if an intangible fixed asset is acquired together with other assets, this transaction may involve the transfer of certain rights (contractual or legal) that enable the entity to identify certain intangible fixed assets (DAS 210.109-111).

Goodwill in an acquiree's balance sheet (resulting from prior acquisitions by the acquiree) cannot be considered an identifiable asset by the acquirer. Goodwill from previous acquisitions is, as it were, always absorbed into the goodwill paid in a later acquisition.

Example: Goodwill in balance sheet of acquiree

A, a private limited liability entity, buys 100% of the shares of B (also a private limited liability entity). The purchase price is 100. The fair value of B's identifiable assets and liabilities is 70. In addition, B has capitalised an amount of goodwill of 20. This goodwill is the result of previous acquisitions made by B in the period before B is acquired by A.

A does not classify the goodwill paid by B on previous acquisitions as an acquired identifiable asset. Therefore, the goodwill paid by A is 30 (= 100 - 70).

Criteria for recognition

The identifiable assets and liabilities must be recognised separately on the balance sheet at their fair values, provided the following conditions are met (DAS 216.208):

- it is probable that future economic benefits will flow to the acquirer or the settlement will result in an outflow of resources embodying economic benefits; and
- its cost or fair value can be measured reliably.

Acquired assets and liabilities that do not meet the aforementioned criteria influence the amount of (negative) goodwill, as goodwill is determined as the difference between the acquisition cost and the value of the identifiable assets and liabilities. The identifiable assets and liabilities of which the acquirer acquires control may include assets and liabilities that were previously not recognised in the acquiree's balance sheet. This may be because they were not eligible for recognition before the acquisition. For example, this could be a deferred tax asset pursuant to carry-over tax losses that can be utilised after the acquisition (DAS 272.505). Or a trade mark right which was developed internally by the acquiree and which was not capitalised by the acquiree (DAS 216.210, see paragraph 5.3.1).

Example: Internally developed trade mark right

A, a private limited liability entity, buys 100% of the shares of B (also a private limited liability entity). B has an internally developed trade mark right. The fair value of the trade mark right can be determined with sufficient reliability and amounts to 200. B was not allowed to capitalise this trade mark right on the basis of DAS 210.229. As a result of the acquisition, A must capitalise the trade mark right for the fair value of 200. After all, the trade mark right is an identifiable asset that meets the recognition criteria of DAS 216.208.

Example: Customer base

Private limited liability entity A buys 100% of the shares of private limited liability B. B has an extensive customer base. A expects that because B has built up customer relationships and customer loyalty, customers will continue to do business with B according to a churn rate estimated on the basis of historical data. However, there is no legally enforceable basis for this. It is not uncommon in the market for customer bases similar to those acquired by A to be traded separately between independent market participants. Examples of such customer databases are customer databases of telecom companies or energy companies.

DAS 210.115 provides that where there are other ways (i.e. other than in a legally enforceable basis) to protect customer relationships and customer loyalty to B, there is control over the economic benefits. The definition of a intangible fixed asset is then met. However, the Dutch Accounting Standards do not provide further guidance on 'other ways to protect customer relationships'. We believe that, by analogy with IAS 38.16, there is control over the economic benefits of customer databases when separate transactions take place in similar customer databases, which is the case in this example. As a result, those customer bases meet the definition of an intangible asset. If the recognition criteria of DAS 216.208 are also met, A must capitalize the customer base as a result of the acquisition.

Liabilities
No liabilities should be recognised arising from the intentions or actions of the acquirer. Nor should liabilities be recognised for future liabilities, losses or other expected costs arising from the acquisition, whether they relate to the acquiree or the acquirer (DAS 216.211). Since these liabilities did not exist for the acquiree on the acquisition date, they are not taken into account in determining the fair value of identifiable assets and liabilities by the acquirer. Thus, only liabilities existing for the acquiree that meet the criteria for recognising a liability are included as part of the identifiable assets and liabilities acquired.

Restructuring provisions are an exception
An exception is the situation in which the acquirer has plans regarding the activities of the acquiree that create a liability as a direct result of the acquisition. Only in that situation is the acquirer required to recognise a restructuring provision on the acquisition date, provided specific conditions are met. On or before the acquisition date, the acquirer must have developed the outline of a plan for the termination or reduction of the acquiree's activities related to (DAS 216.212):

- compensating employees of the acquiree for the termination of their employment;
- closing business units of the acquiree;
- the divestment of product lines of the acquiree; or
- the termination of onerous contracts of which the acquirer has already notified the other party to the contracts on or before the acquisition date that they will be terminated.

Furthermore, on or before the acquisition date, the acquirer must have raised a reasonable expectation in those affected by the restructuring that the plan will be implemented by announcing the outline of the plan for the termination or reduction of activities.

The restructuring provision may only include the costs related to the aforementioned four points (DAS 216.212). See also Annex 1 to this chapter for a schematic overview of the formation of a restructuring provision by the acquirer.

Within a reasonable time after the acquisition date, the acquirer must have further formalised the outline of the plan in a detailed formal plan, which at least includes (DAS 216.212):

- the activities, or parts of activities, involved;
- the principal locations;
- the location, function and expected number of employees who will receive compensation for the termination of their employment;
- the expenditures involved;
- when the plan will be implemented.

A reasonable time is understood to mean three months after the acquisition date. Under certain circumstances, a longer period, with a maximum of six months, may be justified. This means that if the acquirer has included a provision on the basis of the outlines of the plan, the plan will, shortly thereafter
- but no later than six months after the acquisition date - have to be formalised in a detailed plan. Furthermore, the acquirer must correct the resulting adjustment to the provision for positive or negative goodwill (DAS 216.212).

Deferred taxes as a result of acquisition
In the recognition of the acquired identifiable assets and liabilities, there is sometimes a lack of clarity in practice about the way in which deferred taxes should be dealt with. Generally, the tax bases of assets and liabilities will not change (or will not change to the same extent) as a result of the acquisition. This means that differences arise with the (commercial) carrying amounts determined at the time of the acquisition. In general, these are taxable or deductible temporary differences, for which a deferred tax liability or asset must be recognised (DAS 272.301 and 305). These deferred taxes affect the amount of goodwill (DAS 272.505). After all, the amount of goodwill is determined as the difference between the acquisition cost and the fair values of the identifiable assets and liabilities on the acquisition date.

The amortisation of goodwill is often not tax deductible. In that case, the acquirer does not recognise a deferred tax liability or asset on the positive or negative goodwill itself (DAS 272.505). Goodwill that is not tax-deductible as a result of an acquisition of another company falls under the differences that do not lead to a deferred tax asset or liability under DAS 272.104 as a result of the participation exemption. This is because it concerns a temporary difference that, when the goodwill is realised, will not lead to tax due for future reporting periods. In addition, goodwill is the result of the measurement of the acquired identifiable assets and liabilities. If this were to be increased by a deferred tax asset or liability on the goodwill itself, this would conflict with the principle that the goodwill is a residual item. And in addition, the resulting iterative process in the measurement (deferred tax asset or liability on goodwill leads to an increase in goodwill, which in turn leads to a deferred asset or liability, etc.) creates a complexity that does not lead to useful information for the user of the financial statements.

Example: Deferred taxes when recognising identifiable assets and liabilities

A, a private limited liability entity, purchases 100% of the shares in B (also a private limited liability entity) for an amount of 2,000. The visible equity of B at the time of the acquisition amounts to 1,500. B has an internally developed trade mark right of which the fair value can be determined reliably. The fair value is 200. B was not allowed to capitalise this trade mark right on the basis of DAS 210.229. As a result of the acquisition, A must capitalise the trade mark right for the fair value of 200. After all, the trade mark right is an identifiable asset that meets the capitalisation criteria of DAS 216.208. In addition, the fair value of B's buildings is 200 higher than the carrying amount for which it is included in B's balance sheet.

In all other respects, there are no differences between the fair values of the identifiable assets and liabilities and the carrying amounts according to B's balance sheet. The tax bases of B's assets and liabilities do not change as a result of the acquisition. A values deferred taxes at the nominal rate of 25%. A determines the goodwill paid by it as follows:

Acquisition cost		2,000
Fair value of identifiable assets and liabilities:		
• Visible equity	1,500	
• Capitalisation of trade mark right at fair value	200	
• Adjustment of tangible fixed assets to fair value	200	
• Recognition of provision for deferred taxes (= 25% of 200+200)	(100)	
Net asset value		1,800
Goodwill		200

Non-controlling interest
Non-controlling interest means that portion of a consolidated entity's net income and net assets that does not accrue directly or indirectly to the entity (DAS 216.0). Any non-controlling interest should be recognised on the balance sheet for its proportionate share of the fair value of the identifiable assets and liabilities (DAS 216.213). See also paragraph 31.3.12.

31.3.4 Determining the fair values of the acquired identifiable assets and liabilities

The fair values of the identifiable assets and liabilities are generally determined as follows (DAS 216.214):

- intangible fixed assets at fair value, determined based on:
  - reference to an active market as described in Chapter 5; and
  - where no active market exists, at the amount that the party would have paid for the asset in a transaction between knowledgeable and willing independent parties;
- land and buildings at fair value;
- machinery, equipment and other fixed assets at fair value, normally based on appraisals. When no fair value is known due to the specific nature of the assets or because the assets are rarely sold except as part of an enterprise as a whole, the assets are valued at current cost;
- receivables against the present value of the amounts to be received, determined on the basis of an appropriate interest rate less any provisions for uncollectibility and collection costs. Measurement at present value is not required for short-term receivables when the difference between the present value and the nominal amount is immaterial;
- marketable assets at current market prices;
- non-marketable assets at the estimated values that may be based on, among other things, price-earnings ratios, the expected dividend yield and expected growth rates of comparable assets of parties with similar characteristics;
- inventory:

- finished products and goods for resale at selling prices, less the sum of the delivery costs and a reasonable portion of the profit for the selling effort of the acquirer based on the profit on comparable finished products and goods for resale;
  - work in progress at the selling prices of the finished product, less the sum of the costs of preparing the product, the delivery costs and a reasonable portion of the profit for the completion and selling effort based on the profit on comparable finished products; and
  - raw materials and consumables at current cost;
- tax assets and liabilities at either the nominal or the present value of the amounts payable or receivable (see Chapter 17). The tax asset or liability is determined taking into account the tax effect of measuring the identifiable assets and liabilities at fair value. Tax assets also include the acquiree's deferred tax assets pursuant to carry-over tax losses which were not valued prior to the acquisition, but qualify for capitalisation as a result of the acquisition;
- provisions, long-term debts, accounts payable, accruals and deferred income and other liabilities at the present value of the amounts spent to meet the obligations, determined using an appropriate interest rate. Measurement at present value is not necessary for current debt when the difference between the face value and the present value is immaterial;
- liabilities and receivables under pension schemes in accordance with DAS 271.3 as described in paragraph 18.5;
- provisions for the termination or reduction of activities of the acquiree, as described in paragraph 31.3.3, which qualify for recognition at the amount determined under DAS 252 as described in Chapter 16; and
- contracts to be terminated and other liabilities of the acquiree at the present value of the amounts payable based on an appropriate interest rate.

For non-interest bearing receivables and debts for which only the time value is to be shown, an appropriate interest rate means: the risk-free interest rate (effective interest rate on long-term government bonds). For interest-bearing receivables or debts, an appropriate interest rate means: the market interest rate applicable to similar assets.

Determining the fair values of certain assets or liabilities can be so complex that the assistance of measurement experts may be required. When the fair value of an intangible fixed asset cannot be determined by reference to an active market, the amount to be capitalised must be limited to an amount that does not create or increase negative goodwill (DAS 216.215).

Example: Determining and recognising fair values

M buys 100% of Target's shares for 5,000. Target's balance sheet on the acquisition date is as follows:

Tangible fixed assets	2,000	
Inventory	600	
Accounts receivable	500	
Other current assets	200	
Share capital		100
Other reserves		900
Non-current debt		1,500
Current debt		800
	3,300	3,300

Furthermore, the following information is provided with regard to Target:

- there is an identifiable self-developed publishing right with a fair value of 1,000;
- tangible fixed assets are valued at 6,000;
- the fair value of the inventory is 800;
- the conditions are met to recognise a restructuring provision on the acquisition date, which is calculated at 1,200;
- the fair value of the other assets and liabilities is equal to the balance sheet value.

The acquisition is then recognised as follows:

Equity of Target according to balance sheet		1,000
Publishing right to be identified	1,000	
Added value of tangible fixed assets	4,000	
Added value of inventory	200	
Restructuring provision	(1,200)	
	4,000	
Tax effect (nominal 25%)*	1,000	
		3,000
Fair value of identified assets and liabilities		4,000
Purchase price		5,000
Goodwill		1,000

* The tax effect is calculated nominally as M recognises all deferred taxes at the nominal tax rate. DAS 272 also allows measurement of deferred taxes at present value.

The journal entry of the acquisition for recognition in M's consolidated financial statements is as follows:

Goodwill	1,000	
Intangible fixed assets	1,000	
Tangible fixed assets	6,000	
Inventory	800	
Accounts receivable	500	
Other current assets	200	
Restructuring provision		1,200
Provision for deferred taxes		1,000
Long-term debt		1,500
Current debt		800
Bank (or debt on account of acquisition)		5,000

At company level, the recognition at M is as follows:

Goodwill	1,000	
Participating interest of Target	4,000	
Bank (or debt on account of acquisition)		5,000

Target is not allowed to adjust the carrying amounts of its assets and liabilities in its own financial statements to reflect the (initial) measurement of identifiable assets and liabilities used by the acquirer (also known as 'push down accounting') (DAS 216.249). Target is only allowed to change accounting policies in accordance with DAS 140. However, this will seldom lead to an equal measurement. For example, Target may adjust the measurement basis to measure tangible fixed assets to the basis used by M to measure tangible fixed assets. Suppose M values the tangible fixed assets at current value, then Target can also do this. However, on acquisition, M must value the tangible fixed assets at fair value on the acquisition date, while Target must measure them at current value on measurement. It can only be ensured that the measurement of assets in M is equal to the measurement in Target if there is a possible measurement at fair value (such as investment property, for example). See also paragraph 31.3.8.

In the year following the acquisition, M will have to correct the profit or loss determined and recognised by Target in its consolidated and company-only financial statements in order to determine the net asset value of the participating interest in Target. After all, M will have to recognise this profit or loss on the basis of its own accounting principles. This means that the fair values assigned to the assets and liabilities on the acquisition date must be taken into account, among other things. For example, when determining Target's profit or loss, the following must be taken into account:

- the amortization of the identified publishing right based on the fair value of 1,000;
- the depreciation based on the fair value of the tangible fixed assets of 6,000;
- the fact that the fair value of the inventory on the acquisition date is determined at 800;
- the fact that a restructuring provision of 1,200 was recognised on the acquisition date. The expense entered by Target in this respect is not part of the profit or loss to be recognised by M (in consolidated financial statements).

31.3.5 Positive and negative goodwill in case of an acquisition

Positive goodwill exists if the acquisition cost is higher than the acquirer's share in the fair values of the acquired identifiable assets and liabilities at the time of the transaction. Negative goodwill exists if the acquisition cost is lower than the acquirer's share in the fair values of the acquired identifiable assets and liabilities at the time of the transaction. For a detailed description of the further treatment of positive and negative goodwill in the financial statements, reference is made to Chapter 6.

31.3.6 Step acquisition

General
A step acquisition means that an acquisition comes about because an interest already held is expanded in such a way that control is acquired (DAS 216.102). A step acquisition also exists if a participating interest repurchases own shares from other shareholders as a result of which the relative interest of the participating entity in that participating interest increases to such an extent that control is obtained (DAS 216.205).

A step acquisition can be recognised in two different ways, namely (1) without and (2) with revaluation of the existing interest.

With both recognition methods, the acquisition cost of the step acquisition is the sum of the acquisition cost of the individual transactions, i.e. as at the dates of those individual transactions (DAS 216.204).

In the first recognition method, the fair values of the acquiree's identifiable assets and liabilities are then determined on the basis of the dates on which each separate acquisition is recognised in the acquirer's financial statements (DAS 216.204). The goodwill is the difference between the sum of the acquisition cost and the fair value of the identifiable assets and liabilities on the dates of the individual transactions. With this recognition method, no revaluation takes place of the interest originally held in the acquiree.

With the second recognition method, it is allowed, in accordance with IFRS 3, to recognise the identifiable assets and liabilities of the original interest already held at fair values as at the acquisition date (i.e. the date on which control was acquired). An adjustment of the identifiable assets and liabilities based on their fair value related to the interest already held is a revaluation and is recognised in a revaluation reserve in accordance with Article 2:390 NCC. Such a revaluation of the interest originally held may only take place at the time when control is acquired (DAS 216.204). Therefore, not if an existing minority interest is expanded without acquiring control.

In a step acquisition, any non-controlling interest is included for the proportional share of the fair value of the identifiable assets and liabilities on the acquisition date. This also applies when the acquirer does not revalue the identifiable assets and liabilities of the interest already held (DAS 216.204). See also paragraph 3.12 of this chapter for the recognition of the non-controlling interest in an acquisition.

When determining the fair values of the identifiable assets and liabilities, the fair values may appear to have decreased on balance compared to the carrying amounts of these assets and liabilities on the acquisition date. This is an indication of a possible impairment of assets and liabilities related to the interest already held. For example, the creation of negative goodwill in a step acquisition could indicate the existence of such impairment.

Example: Step acquisition

Entity A owns 50% of the shares in entity B. Participating interest B is measured at net asset value. As at 31 December of any year, the equity of participating interest B based on A's accounting principles amounts to 850. The value of the participating interest in the company-only and consolidated financial statements of A is 50% of 850 or 425. There is no goodwill.

On 31 December of that year, the remaining 50% of the shares in entity B is acquired at 1,500. The fair value of B's individual assets and liabilities amounts to 2,100 as at that date. In principle the participating interest in A's company-only financial statements is measured at 1,475 (= 425 + 1,050). In addition, goodwill is capitalised for 450 (= 1,500 - 50% of 2,100).

A practical difficulty arises in the phased purchase of a participating interest when including it in the consolidation. After all, the individual assets and liabilities of the participating interest are included in the consolidation on the basis of their fair values at the time of acquisition of the equity interest. Because the first 50% was acquired at a different time than the second 50%, both layers are in principle included in the consolidation at different values. DAS 216 does not regulate this. According to DAS 217.501, the assets and liabilities must be included in the consolidated financial statements for 100%.

DAS 216.204 allows in such situations to include the assets and liabilities of B in full at their fair values as at 31 December.

The oldest layer (the 50% interest already owned) is then revalued by 625 (= 1,050 - 425). The capital gain is included in a revaluation reserve.

This also implies that participating interest B is measured at 2,100 in A's company-only financial statements. A revaluation reserve of 625 is also recognised. The creation of a revaluation reserve does not mean that the company must follow the accounting principle of current value. This is a one-off revaluation.

This is recognised in the consolidated financial statements as follows:

Goodwill (= 1,500 - 50% of 2,100)	450	
Assets and liabilities of participating interest B	2,100	
Participating interest B		425
Revaluation reserve (= 1,050 - 425)		625
Bank (or debt on account of acquisition)		1,500

The recognition in the company-only financial statements is as follows:

Goodwill	450	
Participating interest B (= 2,100 - 425)	1,675	
Revaluation reserve (= 1,050 - 425)		625
Bank (or debt on account of acquisition)		1,500

Another method of recognition is not to adjust the fair values of the identifiable assets and liabilities related to the interest already held.

In that case, the recognition in the consolidated financial statements is as follows:

Goodwill	450	
Assets and liabilities of participating interest B (= 425 + 1,050)	1,475	
Participating interest B		425
Bank (or debt on account of acquisition)		1,500

In that case, the recognition in the company-only financial statements is as follows:

Goodwill	450	
Participating interest B	1,050	
Bank (or debt on account of acquisition)		1,500

31.3.7 Adjustments of acquisition cost depending on future events

Acquisition cost may be adjusted later depending on future events. If the acquisition agreement provides for a possible adjustment of the acquisition cost depending on future events and it is probable that the adjustment will take place and its amount can be determined reliably, this adjustment of the acquisition cost must be recognised on the acquisition date (DAS 216.239).

When recognising an acquisition, it is generally possible to estimate adjustments to acquisition cost, despite the fact that some uncertainties remain, without affecting the reliability of the information. If future events subsequently do not occur, or if the estimate has to be revised, the acquisition cost will be revised and the (negative) goodwill will also be adjusted (DAS 216.240). There is no time limit for this.

In determining this, the time value of the money must be taken into account in any case. After all, if settlement of the purchase price is postponed, the acquisition cost is set at the present value of the deferred purchase price

(DAS 216.203). In that case, it must be possible to set a period over which the present value is calculated. If the selling party could claim the deferred purchase price at any point in time, the remaining purchase price obligation should be recognised at settlement value on the reporting date.

The acquisition cost must be subsequently adjusted if an uncertainty affecting the amount of the purchase price ceases to exist after the date of acquisition, as a result of which payment of the amount is probable and a reliable estimate can be made (DAS 216,241). The adjustments are recognised in the year (or years) in which the changes to the estimates are implemented and/or the actual payments are received or made. Comparative figures are not adjusted. The adjustment of the acquisition cost affects the amount of goodwill. The change in the uncertain acquisition cost is, at the moment of the change, adjusted to the goodwill and recognised as a change in accounting estimate. The adjusted goodwill is then amortised prospectively (DAS 216.242).

For example, the purchase price may be made dependent on the profit or loss to be achieved by the acquiree during a certain period after the acquisition (earn-out arrangement). If the adjustment to the purchase price becomes probable and the amount can be reliably determined, the acquirer recognises the purchase price adjustment as an adjustment to the acquisition cost and the resulting adjustment to the (negative) goodwill (DAS 216.242). There is no time limit for this.

Example: Recognition of earn-out arrangement

Entity M acquires 100% of the shares of entity D on 1 January. The acquisition cost consists of a cash payment of 300 plus 50% of the profit for the coming financial year. The profit is initially estimated at 40. The estimated payment is therefore 320 (300 plus 50% of 40). Suppose the present value of the earn-out liability is 18. The acquisition cost is then set at 318 on the acquisition date.

After one year it turns out that the final profit is 60, which means that the additional payment is 30. The acquisition cost (and thus the goodwill) is now adjusted on the basis of the present value on 1 January. The new acquisition cost is 327 (= 300 plus the present value of 30, say 27). The change in the acquisition cost and goodwill of 9 (= 27 - 18) is recognise in the year in which the change in estimates is implemented. This correction will also affect the amount of goodwill to be amortised. Because it concerns a change in accounting estimate, the comparative figures are not adjusted, but the (accumulated) effect on the amortisation of goodwill is recognised in the profit and loss account (see also the example below). By discounting the deferred part of the acquisition cost, interest also accrues to the nominal amount. In this example, this amounts to 3 and is recognised as interest expense. When it comes to subsequent adjustment of this interest expense, too, comparative figures are also not adjusted if it later transpires that the accrued interest component must be changed.

The amount of the acquisition cost may change because an uncertainty affecting the amount of the purchase price (such as an agreed contingent consideration) has ceased to exist after the acquisition date. Such a change concerns a correction to the previously recognised acquisition cost on the acquisition date. This correction arises from the accounting policy prescribed by the Dutch Accounting Standards Board that the part of the purchase price that is not probable and the amount of which cannot be reliably determined, cannot yet be recognised (DAS 216.239). If these criteria are subsequently met, the acquisition cost (and thus the goodwill) will be adjusted for the size of that sum (gross). This adjustment to the acquisition cost concerns a change in accounting estimate that must be recognised prospectively, i.e. via the profit and loss account of the current and future periods (DAS 145.301). The question is whether or not catch-up amortisation should be recognised in the current period and whether or not the accumulated amortisation of goodwill should be adjusted as a result. Due to the lack of specific firm statements in this regard, two views are possible, which we summarise below. These examples have been abstracted from the time value of the money.

Recognising catch-up amortisation
DAS 216.221 stipulates that capitalised goodwill must be systematically amortised over its estimated economic life. This paragraph explicitly establishes a link between the amortisation period and the economic benefits related to the goodwill that are expected to accrue to the entity. This argues for the view that the balances of the goodwill and the accumulated amortisation should correspond to the balances that would have been recognised if the newly determined acquisition cost had already been recognised on the acquisition date. The adjustment to the accumulated amortisation may concern an exceptional item in the profit and loss account (see paragraph 23.4.2). In fact, this concerns a correction of the amortisation charge for previous periods.

Example: Adjustment of acquisition cost with recognition of catch-up amortisation of goodwill

A acquired 100% of B in mid-year 1. In connection with this acquisition, a purchase price of 50 and an earn-out arrangement have been agreed for years 2 and 3. An amount of 10 (before tax) is agreed as the accumulated standard profit for years 1, 2 and 3 (from the acquisition). In case of accumulated higher profit for that period, 50% of the surplus profit above the standard profit will still be settled between the parties. At the time of acquisition, A does not consider an accumulated surplus profit to be likely and has therefore not recognised it. Goodwill is amortised to nil over 10 years.

The following data are available at the time of acquisition:

Acquisition cost	50
Fair value of assets and liabilities B	30
Goodwill	20

Entry of acquisition (consolidated):

Assets and liabilities	30	
Goodwill	20	
Bank		50
Earn-out liability		0

At the end of year 1 and year 2, there was no reason for A to reconsider the recognition of the earn-out liability. When preparing the financial statements for year 3, it appears that an accumulated surplus profit of 8 has been realised by B. This is the result of better-than-expected profit during year 3. A must therefore pay an additional amount of 4.

With an amortisation period of 10 years, the carrying amount of the goodwill at the end of year 3 is: 15 (after 2.5 years of amortisation).

Now that the earn-out liability is known, the acquisition cost of B amounts to 54 instead of the previously determined 50. The goodwill was therefore understated by 4. On the acquisition date, 20 instead of 24 of goodwill was recognised. Assuming goodwill of 24 on the acquisition date, the carrying amount of the goodwill at the end of year 3 would be 18 (= 24 – (2.5 x (24 / 10))).

At the end of year 3, A makes the following entry (in addition to the goodwill amortisation of 2 (= 20 / 10) already entered in year 3:

Goodwill (= 4 - 1)*	3	
Goodwill amortisation expense (exceptional charge**)	1	
Earn-out liability		4

* The example dispenses with the time value of money.
** The exceptional charge consists of the correction of the amortisation charge over 2.5 years. This is 1 (= 4 / 10 x 2.5).

No recognition of catch-up amortisation
The view not to recognise catch-up amortisation follows from an example included in DAS 145.301. This paragraph cites as an example of a change in accounting estimate that affects only the balance sheet items, the adjustment of the acquisition cost of an acquiree where the goodwill is capitalised on the balance sheet. In that case, in the example above, the gross adjustment of goodwill amounting to 4 is amortised over the remaining economic life (7 years) of the goodwill.

31.3.8 Subsequent changes in the consideration

Subsequent changes in the consideration need not lead to a change in the value of the (negative) goodwill. In some cases, the acquirer must make additional payments to the (shareholders of the) acquiree to compensate for a reduction in the value of the consideration. This is the case, for example, when the acquirer has guaranteed the market prices of shares issued as part of the purchase price and the acquirer must issue additional shares to meet the original purchase price obligation. In such cases there is no increase in the acquisition cost and therefore no adjustment of the (negative) goodwill. Instead, the additional issue represents an adjustment of the share premium based on the original issue (DAS 216.243).

Example: Changes in the value of the consideration		
A acquired 100% of B at the end of year 1. A purchase price of 50 million has been agreed in connection with this acquisition. The fair value of the identifiable assets and liabilities of B amounts to 30 million on the acquisition date. This purchase price will be paid as follows: 10 million in cash and 40 million in shares in A, which are newly issued by A. This concerns 100,000 shares, with a face value of 100, at a fair value of 400 on the acquisition date. The fair value is determined by means of an established measurement model. A guarantees the fair value of 400 in the sense that if at the end of year 3 the fair value of the issued shares is lower than 400, additional shares will be issued by A to the seller of B to compensate for this. At the end of year 3, the fair value of the issued shares in A amounts to 320. So at the end of year 3, A must issue 25,000 (= (100,000 x (400 - 320)) / 320) additional shares with a face value of 100 to compensate the seller of B. The entry on the acquisition date is as follows:		
Participating interest (net asset value)	30 million	
Goodwill	20 million	
Cash		10 million
Share capital		10 million
Share premium reserve		30 million
At the end of year 3, the entry is as follows:		
Share premium reserve	2.5 million	
Share capital		2.5 million

31.3.9 Subsequent identification or subsequent changes in the value of identifiable assets and liabilities

Assets and liabilities may be identified later or there may be subsequent changes in the value of the identified assets and liabilities. Identifiable assets and liabilities that have been acquired but do not meet the criteria for separate recognition in the initial recognition of the acquisition should be recognised later if they meet those criteria.

Subsequent to the acquisition, the carrying amounts of the identifiable assets and liabilities acquired should be adjusted if additional information becomes available to support the estimate of the amounts of the identifiable assets and liabilities in the initial recognition of the acquisition. The amounts allocated to (negative) goodwill should also be adjusted, if necessary, to the extent that (DAS 216.244):

- the adjustment does not lead to an increase in the carrying amount to an amount higher than the recoverable amount as referred to in DAS 121 (and described in Chapter 10); and
- such adjustment is made before the end of the first financial year that started after the acquisition (DAS 216.244).
  An exception to this is the amendment of a restructuring provision in the acquisition process, as described in paragraph 31.3.3. A different (shorter) timetable applies to this. The detailed restructuring plan, as described in DAS 216.212, must be formalised no later than six months after the acquisition date. A resulting adjustment to the restructuring provision that was recognised based on the outlines of the plan is adjusted to the goodwill (DAS 216.212). Subsequent adjustment to the provision will not be adjusted to the goodwill but credited or charged to profit or loss with the exception of the situation where the provision is reversed (see below). The maximum of six months within which the restructuring must be formalised ensures that, while arbitrary in length, goodwill is not continually reviewed and adjusted.

In other cases, the adjustments to the identifiable assets and liabilities must be recognised in the profit and loss account (DAS 216.244).

For example, the carrying amount of goodwill is adjusted if:

- there appears to be an impairment loss for an identifiable asset and this is determined before the end of the first financial year after the acquisition and this loss does not result from a specific event or change of circumstances after the acquisition date (in other words: the impairment already existed on the acquisition date);
- the gains from offsettable losses or other deferred tax assets of the acquiree that were not identified as an identifiable asset by the acquirer on the date of acquisition are designated as identifiable before the end of the first financial year after the acquisition.

Recognition method
Subsequent adjustments to the carrying amounts of the acquired identifiable assets and liabilities are recognised as follows (DAS 216.247):

- the carrying amounts of the acquired identifiable assets and liabilities are adjusted as if the adjusted fair values had been used from the date of acquisition. As a result, the adjustment includes both the effect of the fair value adjustment applied in the first instance, and the effect of using the adjusted fair values on amortisation and other movements from the time of acquisition;
- the carrying amount of the positive or negative goodwill is recalculated taking into account the adjusted fair values, also adjusting the amortisation charge of the positive goodwill or the recognition of the negative goodwill from the date of acquisition; and
- the net profit or loss of the adjustments described above is charged or credited to the profit and loss account in the period of the adjustment.

Example: Subsequent adjustments to the fair value of identified assets and liabilities

M acquired D for 5,000 on 1 July of any year. The fair value of the acquired assets and liabilities is determined on the acquisition date at 3,000, so that 2,000 of goodwill is recognised. Suppose the amortisation period for the goodwill is set at ten years. Just before the end of the year following the year of acquisition, new insights are obtained into the fair value of the acquired assets and liabilities as at the acquisition date. This turns out not to be 3,000, but 2,000. The difference relates entirely to inventory. The goodwill therefore amounts to 3,000 as at the acquisition date, rather than 2,000. The relevant inventory has now been fully recognised in the profit and loss account as cost of revenue.

The goodwill has now been amortised over 1.5 years, i.e. for an amount of 300. The carrying amount of the goodwill is therefore 1,700 on the date of the adjustment of the value. If on the acquisition date the goodwill had been recognised immediately for 3,000, this amortisation would have been 450 and the carrying amount would have been 2,550.

So M recognises the following correction in a consolidated manner:

Goodwill	1,000	
Inventory		1,000

And then:

Goodwill amortisation expense	150	
Goodwill		150
Inventory	1,000	
Cost of sales		1,000

With regard to the correction, it will be explained in the financial statements that the carrying amount of the goodwill on the reporting date has been adjusted upwards by 850 in connection with a write-down of the provisional fair value of the inventory following the acquisition of D (DAS 216.408).

Reversal of provision for termination or scaling down of activities
If a provision has been recognised for the termination or scaling down of the acquiree's business, as described in paragraph 31.3.3, it may occur that:

- the outgoing flow of resources is no longer probable; or
- the detailed formal plan is not implemented in the manner set out in the plan or within the time frame of the formal plan.

In that case the carrying amount of the provision must be reversed. Such a reversal should be recognised as an adjustment to positive or negative goodwill in such a way that it does not affect the profit and loss account. An adjusted positive goodwill amount should be amortised prospectively over its remaining life (DAS 216.248). An adjusted negative goodwill amount should be treated in accordance with paragraph 6.3.1.

Example: Release of provision for termination or scaling down of activities

At the time of the acquisition of 100% of the shares in B, A made the following consolidated entry:

Assets – Liabilities	4,000	
Goodwill	2,000	
Bank		6,000

Part of the recognised liabilities is a restructuring provision of 1,000 in connection with the redundancy of B's staff, which restructuring must take place within the scope of the formal restructuring plan (12 months). At the end of this period, it appears that due to an increasing need for staff capacity, fewer staff members will have to be made redundant than foreseen in the plan. The redundancy provision has been used for 600 and the remaining 400 is no longer needed for the purpose of the provision and is to be deducted from the carrying amount of the goodwill. This goodwill has now been depreciated one year, based on a depreciation period of 10 years and according to a straight-line pattern. The carrying amount of the goodwill at the end of the restructuring period is therefore 1,800 (2,000-200).

Subsequently, A makes the following entry:

Restructuring provision	400	
Goodwill		400

The goodwill amortisation is not adjusted for the period before the time of the changed plans. After this write-down, the goodwill amounts to 1,400. This is amortised over the remaining economic life of 9 years (= 155,6 per year.) The adjustment to the goodwill in connection with the reversal of the restructuring provision therefore only has a prospective effect (based on DAS 216.248).

Benefits from offsettable losses or other deferred tax assets

The benefits from offsettable losses, or other deferred tax assets of the acquiree that were not designated as identifiable assets by the acquirer at the date of acquisition may sometimes be realised later. When this occurs before the end of the first financial year that started after the acquisition, the acquirer recognises the benefit as follows:

- the gross carrying amount of the goodwill and its accumulated amortisation are adjusted to the level that would have been recognised if the deferred tax asset had been recognised at the time of the merger or acquisition; and
- the reduction in the net carrying amount of the goodwill is recognised as an expense.

Example: Offsettable loss

M purchased Target at the end of year 1 for 8,000, setting the fair value of Target's identified assets and liabilities at 5,000 and goodwill at 3,000. An offsettable loss of Target of 2,000 was not taken into account here, as its realisation was estimated as insufficiently probable. The goodwill paid is amortised over 10 years. The carrying amount of the goodwill at the end of year 2 is therefore 2,700 (= 3,000 x 9 / 10).

In the financial year following the acquisition, it appears that this offsettable loss can still be utilised. If the offsettable loss had been measured on the acquisition date (for 25% of 2,000 = 500), the goodwill would have been set at 2,500 (= 3,000 - 500). After one year, the carrying amount of the goodwill would have been 2,250 (= 2,500 x 9 / 10).

The correction journal entries are then as follows:

Deferred tax asset	500	
Goodwill		500

And

Goodwill	50	
Adjustment of goodwill amortisation expense (P&L)		50

31.3.10 Recognition at the level of the acquiree ('push down accounting')

The acquiree is not allowed to adjust the carrying amounts of its assets and liabilities in its own financial statements to reflect the (initial) measurement of identifiable assets and liabilities used by the acquirer (also known as 'push down accounting'). This does not alter the fact that the acquiree is allowed to change accounting policies in accordance with DAS 140 (DAS 216.249).

For example, the acquiree may adjust the basis for the measurement of its inventory or of its property to the bases used by the acquirer for the measurement of these assets. Examples of adjustments that the acquiree may not make include capitalising the goodwill paid by the acquirer itself or adjusting the measurement of existing debt to the fair value of that debt. See also the example 'Determining and recognising fair values' included in paragraph 31.3.4.

31.3.11 Reverse acquisition

A reverse acquisition is the situation where the legal acquirer (A) issues so many shares to the shareholders of the legal acquiree (B) that B's shareholders obtain the majority of voting rights in the new combination. Although the party issuing the shares (A) may be legally classified as the acquirer, in this case the party whose shareholders have the controlling interest in the new combination (B) is classified as the acquirer. The party issuing the shares (A) is deemed to have been acquired by the other party (B). The latter is classified as the acquirer in the consolidated financial statements (DAS 216.109). Recognition in the consolidated financial statements therefore takes place according to the economic form of the acquisition transaction, rather than according to the legal form.

Example: Recognition of reverse acquisition

The issued share capital of A consists of 100 shares. A acquires all shares in B, in exchange for 900 newly issued shares in A. The shareholders of B thereby obtain the majority of shares and corresponding voting rights in A. A and B prepare their financial statements based on the same accounting principles.

A's abridged balance sheet on the acquisition date is as follows:

Assets and liabilities	10	
Equity		10
	10	10

Another fact with regard to A is that the fair value of the identifiable assets and liabilities on acquisition date is 15. The fair value of the shares in A at that time (before issue of the new shares) is 20. A's goodwill is 5 (= 20 - 15).

B's abridged balance sheet on the acquisition date is as follows:

Assets and liabilities	100	
Equity		100
	100	100

Another fact with regard to B is that the fair value of the identifiable assets and liabilities on acquisition date is 125. The fair value of the shares in B is 180. B's goodwill is 55
(= 180 - 125).

The consolidated balance sheet as at the acquisition date based on the prescribed recognition method according to economic form is now as follows:

Assets and liabilities of A (excluding goodwill)	15	
Assets and liabilities of B	100	
Goodwill	5	
Group equity		120
	120	120

A is considered the acquiree. A's assets and liabilities are measured at the fair value of the identifiable assets and liabilities. B is considered the acquirer. The carrying amount of the acquirer's assets and liabilities does not change as a result of the acquisition. Goodwill represents the difference between the acquisition cost of the shares in A paid by B (based on a 100% acquisition), and the fair value of the identifiable assets and liabilities acquired (=15). The acquisition cost is set at the fair value of the 'acquired' shares in A and the 'issued' shares in B (= 20) respectively, see paragraph 31.3.2.

Recognition of reverse acquisition in the company-only financial statements of the legal acquirer
To recognise a reverse acquisition in the company-only financial statements of the legal acquirer (A), two recognition methods are possible: according to economic form or legal form (DAS 214.342):

1. based on the recognition method according to economic form, the acquirer is the same as in the consolidated financial statements (B is the economic acquirer). As in the consolidated balance sheet, A's company-only balance sheet remeasures A's assets and liabilities to their fair value and recognises A's goodwill. The participating interest in B is recognised at net asset value as determined based on the carrying amounts of B's assets and liabilities. Based on this recognition method, A's separate equity is equal to its consolidated equity;
2. based on the recognition method according to legal form, the party issuing the shares is considered the acquirer (A is the legal acquirer). This recognition method does create a difference between A's consolidated and separate equity. This is because now A's company-only balance sheet includes B's goodwill, while the consolidated balance sheet includes A's goodwill. In addition, the participating interest in B is recognised at net asset value as determined based on the fair value of B's assets and liabilities.

Example: Recognition of reverse acquisition in the company-only financial statements of the legal acquirer

The data are the same as in the previous example.

Based on the recognition method according to economic form, A's company-only financial statements immediately after recognition of the acquisition read as follows:

Assets and liabilities of A (excluding goodwill)	15	
Participating interest B	100	
Goodwill	5	
Equity		120
	120	120

The difference with the consolidated balance sheet is that B's assets and liabilities are netted in the item 'Participating interest B'.

Based on the recognition method according to legal form, A's company-only financial statements immediately after recognition of the acquisition read as follows:

Assets and liabilities of A	10	
Participating interest B	125	
Goodwill	55	
Equity		190
	190	190

Based on this recognition method, B is considered the acquiree. B's assets and liabilities are measured at the fair value of the identifiable assets and liabilities. A is considered the acquirer. The carrying amount of the acquirer's assets and liabilities does not change as a result of the acquisition. Goodwill represents the difference between the acquisition cost of the shares in B paid by A, and the fair value of the identifiable assets and liabilities acquired (= 125). The acquisition cost is set at the fair value of the acquired shares in B and the issued shares in B respectively (= 180), see paragraph 31.3.2.

This recognition method creates more administrative burden because goodwill must now also be calculated on the assumption that A is the acquirer. We expect this method to be less common in practice.

Based on the recognition method according to legal form, the goodwill of the economic acquirer (B) is recognised, and its assets and liabilities are measured at the (usually higher) fair value. If the combined company created after the acquisition transaction is still effectively the same as the economic acquirer (B), then this recognition method effectively capitalises its own goodwill. Therefore, if the economic reality of the transaction means that the legal acquirer (A) is nothing but a continuation of the legal acquiree (B), that recognition method should not be applied (DAS 214.342). An example is a restructuring where the top holding entity of a group (or the intermediate holding entity of a subgroup) is changed, even though there have been no changes in the economic conditions of the (sub)group as a whole.

31.3.12 Non-controlling interests and options on non-controlling interests

Non-controlling interest
Non-controlling interest means that portion of a consolidated entity's net income and net assets that does not accrue directly or indirectly to the entity (DAS 216.0). Any non-controlling interest should be recognised in the consolidated balance sheet for its proportionate share of the fair value of the identifiable assets and liabilities (DAS 216.213), as part of group equity. See also paragraph 31.3.3.

If at a later date the non-controlling interest (or part thereof) is still acquired, the difference between the acquisition cost and the carrying amount of the non-controlling interest is either recognised as goodwill or charged to equity. See paragraph 31.3.6 on the acquisition of a minority interest in case of an existing controlling interest.

Options on non-controlling interest
In case of acquisitions, it regularly occurs that an option on non-controlling interests (i.e. on the residual interest of the transferor) is obtained or written. This may involve call or put options, or a combination of them. DAS 216 does not specify how such options should be recognised.

The first question to be asked is whether in the circumstances, with the relevant option(s), the option(s), the non-controlling interest has actually already been acquired. For this purpose, a link can be sought with IFRS. Under IFRS, it must be determined whether the options give (immediate) access to the economic benefits of the underlying equity interest (IFRS 10.B90). If so, the non-controlling interest has actually already been acquired. The factors to be considered in that assessment are:

- option pricing;
- voting rights and decision-making powers in relation to the equity interest;
- dividend rights to the equity interest; and
- a combination of call and put options.

Example: Acquisition of minority interest by options (1)

Entity A buys from entity B 90% of the shares of entity Z. The acquisition agreement granted A the right to buy the remaining 10% shares in Z from B for an amount of 1,000 two years after the acquisition date. In turn, B has the right to sell the remaining 10% shares in Z to A for an amount of 1,000 two years after the acquisition date. This 1,000 is based on the current market price of the shares. This acquisition involves paid (positive) goodwill.

Through these options, a 'forward' was effectively agreed, with A having effectively already acquired the remaining 10% interest. After all, if the fair value of the 10% interest exceeds 1,000 after two years, A will in principle exercise his call option. However, if the fair value is lower than 1,000, B will in principle exercise his put option. A then includes in the consolidated balance sheet under group equity not a non-controlling interest but a liability of 1,000 (at present value) because the 10% interest is yet to be paid. This recognition method is also followed in the company-only financial statements by adding a financial fixed asset and goodwill on one hand and a liability of 1,000 (at present value) on the other hand. The 'forward' therefore leads to the recognition of a gross liability but is not independently measured and recognised on the balance sheet.

Example: Acquisition of minority interest by options (2)

Entity A buys from entity B 90% of the shares of entity Z. The acquisition agreement granted A the right to buy the remaining 10% shares in Z from B for an amount of 1,000 two years after the acquisition date. This amount is well below the (expected) fair value, so it is virtually certain that A will exercise its call option. This acquisition involves paid (positive) goodwill.

Through this option, A has effectively already acquired the remaining 10% stake. After all, the option is effectively a ‘bargain purchase option’. A then includes in the consolidated balance sheet under group equity not a non-controlling interest but a liability of 1,000 (at present value) because the 10% interest is yet to be paid. This recognition method is also followed in the company-only financial statements by adding a financial fixed asset and goodwill on one hand and a liability of 1,000 on the other hand (at present value). This ‘bargain purchase option’ therefore leads to the recognition of a gross liability but is not independently measured and recognised on the balance sheet.

If options on third-party interests do not provide (immediate) access to the economic benefits of the underlying interest, they should be recognised separately as derivatives. After all, these options fall within the scope of DAS 290 ‘Financial instruments’ (DAS 290.201: derivatives on shares of group companies, other participating interests over which significant influence is exercised and joint ventures of the entity).

Example: Call option on minority interest

A buys from B 90% of the shares in Z. The purchase price is 9,000 and is paid in cash. The fair value of Z’s identifiable assets and liabilities on the acquisition date is 7,000. The acquisition agreement granted A the right to buy the remaining 10% shares in Z from B for an amount of 1,000 two years after the acquisition date. This amount is equal to the fair value on the acquisition date. The fair value of this option is 100 and is included in the purchase price.

The option is not a ‘bargain purchase option’. It could be that the option is not exercised, so A has not actually already acquired the remaining 10% interest. A then includes a non-controlling interest in the consolidated balance sheet under group equity. In addition, A recognises in its balance sheet a financial asset (derivative) at the fair value of the option on the date of granting (the acquisition date). After all, financial instruments must be measured at fair value on initial recognition (see paragraph 21.6.3). The subsequent measurement depends on the accounting principles chosen (see paragraph 21.6.4).

A makes the following journal entry for the recognition of the acquisition in the consolidated financial statements:

Assets and liabilities of Z	7,000	
Derivatives (call option)	100	
Goodwill	2,600	
Non-controlling interest		700
Cash		9,000
	9,700	9,700

In practice, if the fair value of an option is (almost) zero and will remain so, no recognition needs to take place (i.e. recognition of the option takes place at the fair value of nil). This is the case if the strike price of the option is (almost) equal to and 'moves with' the expected fair value of the relevant shares at the time of exercise. The disclosure requirements of DAS 290 on financial instruments apply to the option (see paragraph 21.10). The example above uses a fixed strike price of 1,000, which means the option will acquire time value. In this example, a value of 100 at the starting time. If, in the example the strike price would be equal to the fair value at the time of exercise, the intrinsic value and the time value (and thus the fair value of the option) will also trend towards nil. After all, in that case, there is no longer any chance of an advantageous settlement.

Written put option on minority interest (no actual acquisition)
If a put option on a minority interest has been written by the entity, the entity is obliged to repurchase the relevant shares upon any exercise of the option by the holder. If such an option relates to the non-controlling interest in a co-consolidated entity, a financial liability must be recognised in the *consolidated financial statements* (DAS 290.807). The liability in the consolidated financial statements should be recognised for the present value of the possible future payment. The liability must be recognised as a charge against equity (DAS 290.805, see also paragraph 21.8.2). If the holder can exercise the put option at any time, the obligation to repurchase shares at strike value should be recognised on the reporting date and therefore no discounting applies.

In the *company-only financial statements*, only the equity interest is recognised in this case. This is because the put option is written on shares that are not part of the entity's equity and this derivative therefore falls within the scope of DAS 290. As financial instruments are measured at fair value on initial recognition, the entity as writer of the put option recognises a financial liability (derivative) at the fair value of the option at the time of entering into the contract (the premium otherwise received for writing the option assuming a market-based transaction). If this premium is included in the purchase price of the acquired controlling interest, this premium is thus segregated. The cost of the acquired interest itself is thus increased by this amount. After all, this amount would have been paid if no option had been written. According to DAS 290, the subsequent measurement of the derivative may then take place at either cost or fair value, at least insofar as the underlying shares are not listed and, of course, subject to a consistent policy (see paragraph 21.6.4.2). In practice, if the fair value of the option is (almost) zero and will remain so, no recognition needs to take place. This is the case, as explained above, if the strike price of the option is (almost) equal to and 'moves with' the expected fair value of the relevant shares at the time of exercise.

The foregoing means that consolidated and separate equity and profit or loss respectively will generally diverge in the case of such written put options. After all, in the consolidated financial statements, the put option liability does change (the movement of the liability is recognised in profit or loss) while in the situation outlined (if the strike price of the option is equal to the market value), it remains measured at zero on a company-only basis.

31.4 Recognition of pooling of interests

If a transaction qualifies as a pooling of interests, the pooling of interests method should be applied. This method is explained in more detail in this paragraph. If a transaction does not involve a pooling of interests, the pooling of interests method may not be applied, and the regulations for acquisitions apply (DAS 216.301).

This method aims to achieve reporting of the combination that has the same effect as if the separate entities had continued as before, albeit now under common ownership. Using this method, the combined assets and liabilities are basically recognised at their existing carrying amounts. As a result, no goodwill arises from the transaction. Only the carrying amount of pre-existing goodwill remains capitalised.

The application of the pooling of interests method is not tied to any particular (legal) form of consolidation. For example, there may be a share merger, a legal merger in which one entity merges into another, the creation of a new entity in which the shareholders of the merger partners participate, and participation by the merger partners in each other's intermediate holding entity.

Recognition method
When the pooling of interests method is applied, the assets and liabilities of the joined entities, as well as their income and expenses for the financial year in which the merger is realised and for previous financial years added for comparison, must be included in the financial statements of the joined entities as if the merger had already taken place as from the beginning of those financial years. The pooling of interests should not be recognised in the financial statements for a particular year if the pooling takes place after the reporting date (DAS 216.302).

The pooling of interests method implies that in the case of a merger date that does not coincide with the beginning of a financial year, the profit and loss account reflects the profit or loss of the combined entity as if the merger had already taken place at the beginning of the financial year. This also applies to the presentation of comparative figures. While this departure from the actual merger date gives the profit and loss account a pro forma character to some extent, it is conducive to understanding the combined entity's profit or loss (DAS 216.303).

Recognition of remaining difference
A difference between the nominal amount of the issued share capital (plus any cash or other asset consideration) and the carrying amount of the assets and liabilities underlying the value of the shares acquired in the exchange should be recognised in the reserves (i.e. in the equity) (DAS 216.304). This difference is commonly referred to as share premium. See Chapter 14 for the treatment of possible tax claims on share premium.

Merger costs
Expenses related to the pooling of interests should be recognised as expenses in the year in which they arise. The notes should disclose (an indication of) the sum of the merger costs (DAS 216.305). This is in contrast to costs related to an acquisition, which in practice are usually treated as an adjustment to the acquisition cost (and therefore to the goodwill paid) (see paragraph 31.3.2). Examples of merger costs are: registration costs, restructuring costs

related to the merger, costs related to providing information to shareholders, advisory costs and salary costs attributable to the creation of the pooling.

Recognition in the company-only financial statements
An entity that is part of a pooling of interests and holds interests in one or more merger partners should include those interests in its company-only balance sheet against the visible equity of the merger partners (DAS 216.306). This should then be the visible equity after synchronisation of the accounting principles (see below).

In our opinion, it is preferable to have the recognition in the company-only financial statements of this entity follow more the legal course of events. This entails recognising the acquired participating interests as of the date of acquisition (usually the merger date) in the company-only financial statements. In that case, of course, the comparative figures are not adjusted. As a result, in the year of the pooling, there may be a difference - to be explained in the notes - between the consolidated and separate profit or loss. This is illustrated in the example below.

Example: Recognition of pooling of interests in company-only financial statements

Company A and company B merge on 1 July of any year. The financial year coincides with the calendar year. The merger is achieved by an exchange of shares in which A acquires all shares in B against distribution of shares in A to shareholders of B. This merger qualifies as a pooling of interests. In the consolidated financial statements, the pooling is recognised under DAS 216 in accordance with the pooling of interests method. That is, a recognition as if the merger was already a fact from the beginning of the financial year. The consolidated profit or loss for the first financial year (= calendar year) then consists of the sum of A and B's profit or loss for that year. This also applies to the comparative figures. DAS 216 does not apply to recognition in the company-only financial statements.

A prefers to follow the legal course of events in the company-only financial statements. This involves A acquiring a participating interest from 1 July, which A recognises in its company-only financial statements from that date. In that case, of course, the comparative figures are not adjusted. The carrying amount of the participating interest is set at the balance of the carrying amount of B's assets and liabilities as at the merger date of 1 July. A's company-only profit or loss for this financial year then consists of A's (separate) profit or loss for the first six months and the profit or loss of the combination for the second six months. In this way, A's separate and consolidated profit or loss do not reconcile in the relevant financial year, but there will be no difference between separate and consolidated equity at the end of the financial year. The recognition is explained in the notes. Moreover, the difference between the consolidated and separate profit or loss must be disclosed in the notes to the company-only financial statements (Article 2:389(10) NCC).

An alternative recognition method is to apply the pooling of interests method in the company-only financial statements as well, to ensure that no difference arises between the consolidated and separate profit or loss.

Synchronisation of accounting principles
Although there are no revaluations based on initial measurement at fair values, as is the case with the purchase accounting method, the accounting policies of the merged entities may differ. In that case, the accounting principles should be synchronised into a uniform accounting policy. Acceptance of a uniform accounting policy for the period after the pooling in principle constitutes a change in accounting policies. For the recognition of the effects of a change in accounting policies, reference is made to the relevant information in Chapter 3. When applying the pooling of interests method, the effects of a change in accounting policies should be recognised directly in the opening equity (DAS 216.307). The effect is that the reporting of the combination is based on the synchronised accounting principles.

31.5 Income taxes

The tax treatment of mergers or acquisitions may differ from their recognition in the financial statements. Any deferred tax asset or deferred tax liability arising is recognised in accordance with the provisions of DAS 272 as described in Chapter 17.

The benefits from offsettable losses, or other deferred tax assets of the acquiree that were not designated as identifiable assets by the acquirer at the date of acquisition may sometimes be realised later. If this occurs before the end of the first financial year started after the acquisition, the acquirer recognises the gain as described in paragraph 31.3.9.

31.6 Mergers and acquisitions under common control

DAS 216 does not provide a definition or examples of mergers and acquisitions under common control. Further interpretation of this concept can be found in IFRS. A transaction under common control exists if the same shareholders ultimately have control over the acquirer and the acquiree (or the merging parties), both before and after the acquisition (or merger). Control by these shareholders, i.e. common control, should not be temporary. This is to avoid purchase accounting being wrongly not applied. The shareholders can be entities or natural persons. Control may be exercised by several shareholders, who individually do not have control, but exercise it together through a contractual arrangement.

DAS 216 does not apply to transactions between companies under common control, except for the provision in DAS 216.503 (DAS 216.104). DAS 216.503 specifies the possible recognition methods for mergers and acquisitions under common control. It is not required to classify the merger or acquisition as an 'acquisition' or as a 'pooling of interests'. In principle, for the recognition of mergers and acquisitions under common control, a choice must be made between (DAS 216.503):

- pooling of interest;
- carryover accounting; or
- purchase accounting.

This applies to both the consolidated financial statements and the company-only financial statements of the acquirer (DAS 214.343).

The pooling of interests method is discussed in detail in paragraph 31.4.

The carryover accounting method involves aggregating the carrying amounts of assets and liabilities on the acquisition date. As a result, no new goodwill arises, only the carrying amount of pre-existing goodwill remains capitalised. The comparative figures are not restated. In the company-only balance sheet of the acquirer, the acquired interest is recognised at the balance of the carrying amounts of the assets and liabilities of the acquiree.

For a further explanation of the purchase accounting method, reference is made to paragraph 31.3.

DAS 216.503 and DAS 214.343 state for mergers and acquisitions between companies under common control that these may only be recognised using the purchase accounting method if this does justice to the economic reality of the transaction. The pooling of interests method and carryover accounting method may be applied in any merger and acquisition under common control.

The Dutch Accounting Standards Board has not elaborated on when justice is done to the economic reality of the transaction. The extent to which the economic reality (or economic substance) changes as a result of a merger or acquisition under common control should be assessed. In our view, if economic conditions do not change or change very little, it is more difficult to defend transactions being recognised at fair value. In that case, a choice has to be made between the pooling of interests method and the carryover accounting method.

In addition, we believe that pursuant to Article 2:362(1) NCC, the information needs of the users of the financial statements (the entity's shareholders and other parties using the entity's financial statements) should be considered when choosing the recognition method.

In all cases, it should be clearly explained what transactions have taken place and how they have been recognised, as well as the reason for the recognition method chosen. When choosing a recognition method, an entity should in principle follow a consistent policy. See also paragraph 2.8.1.

Example: Acquisition under common control

A holds 100% of the shares in B, C and D. A wants to change the structure of the group in the sense that B becomes intermediate holding entity and C and D are contributed to B (against issue of shares, against payment on shares already held (share premium) or against debt recognition). The question is whether to trade on the basis of the actual value of the shares of C and D or whether, for simplicity's sake, to trade on the basis of the visible intrinsic value of B and C. There is also the question of whether B, as a new intermediate holding entity, must recognise the acquisition of the shares in C and D as an 'acquisition', which would mean that, regardless of the pricing, all assets and liabilities of B and C must be measured at fair value on initial recognition and recognise goodwill or negative goodwill for the difference with the acquisition cost.

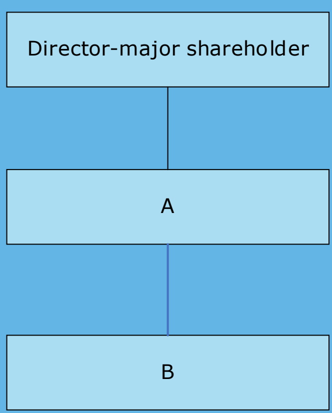
Clearly, nothing changes for A as head of the group. Therefore, A must recognise the transaction at its carrying amount (based on visible intrinsic value).

Another question is at what value the transaction itself should be shaped. There will often be a preference to enter into the transaction on the basis of visible intrinsic value as well. In that situation, the management board members of A and B will have to evaluate carefully what risks will be run if trade is done on that basis. After all, it is quite possible that C and D are worth (much) more than the visible intrinsic value. A's creditors, apart from joint liability in the group, have the shares in B, C and D as recourse for the restructuring. After the restructuring, this only concerns the shares in B. However, B acquires the shares in C and D. So in terms of the value of the property for which recourse is available, nothing actually changes for A's creditors. B's creditors get more recourse through the transaction. So if recognition takes place on the basis of visible intrinsic value, creditors will have no problems with this. So the assessment by the management board members may be that using the visible intrinsic value (= carrying amount) may be an acceptable transaction basis. Recognition may take place on a company-only basis in that situation. In all cases, B can choose to recognise the transaction at carrying amounts, either under the pooling of interests method or under the carryover accounting method. Only if economic reality changes as a result of the merger can B choose to apply the purchase accounting method (DAS 216.503). In that case, the assets and liabilities acquired from C and D are measured at fair value on initial recognition by B and goodwill is recognised.

It is, of course, possible to shape the transaction based on the fair value of the shares in C and D. When recognised by B at carrying amounts, a difference then arises between the acquisition cost and the carrying amounts of the assets and liabilities acquired. That difference is recognised directly in equity.

Example: Merger under common control (1)

A, a private limited liability entity, merges with B (also a private limited liability entity), with A being the acquiring entity and B the disappearing entity. A values B at net asset value. The shares in A are held by a director-major shareholder.

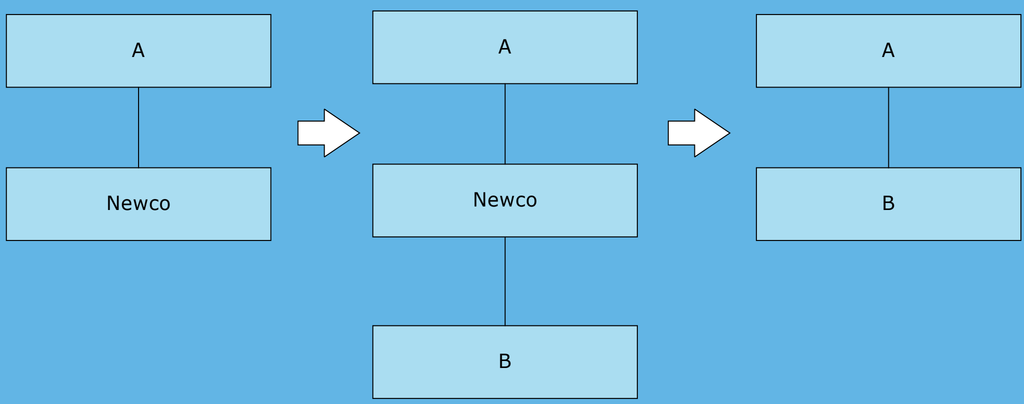


As a result of this legal merger, the economic reality does not change. For example, the configuration (risk, timing and size) of the group's cash flows remained unchanged. We believe that in such a situation, A should recognise B's assets and liabilities at the amounts used in A's determination of B's net asset value. In this way, there is no change in value from A's perspective as a result of the merger. This recognition method does justice to the fact that, from A's perspective, the economic situation has not changed as a result of the merger.

Example: Merger under common control (2)

A, a private limited liability entity, incorporates Newco for the purpose of an acquisition of B (also a private limited liability entity). Immediately after the acquisition, a legal merger takes place between Newco and B, with B being the acquiring entity and Newco the disappearing entity.

The decisive factor for recognition is whether Newco was only incorporated by A as a means to acquire B. In this case, Newco merges with B immediately after the acquisition. On this basis, it is generally difficult to argue that the merger company Newco & B has independent substance. According to DAS 115.107, the financial statements should reflect the economic reality of (the combination of) transactions. At the level of B, A's acquisition through Newco should not affect the financial statements. After all, the economic situation has not changed for B. Only a change of shareholder in B has taken place. The merger between Newco and B should be on the basis of B's carrying amounts. Goodwill that may have arisen in Newco as a result of the acquisition cannot be recognised in B's balance sheet but is deducted from equity. In this way, the situation in which push down accounting is in fact applied indirectly in B's financial statements is avoided. For DAS 216.249 does not allow push down accounting.



For A, it does constitute an acquisition within the meaning of DAS 216 pursuant to which A recognises the acquisition of B using the purchase accounting method.

Carrying amounts to be used when applying pooling of interests and carryover accounting
A particularity arises if an acquiree under common control was acquired externally by the group in the past, which acquisition has been recognised by a common parent using the purchase accounting method. When applying pooling of interests and carryover accounting, one can choose to assume the carrying amounts of assets and liabilities:

- from the financial statements of the relevant acquiree; or
- from a parent's financial statements incorporating the external acquisition of the acquiree at the time.

31.7 Disclosure

31.7.1 General disclosure requirements

The following disclosures should be included for all mergers and acquisitions in the financial statements for the period in which the mergers or acquisitions took place (DAS 216.401):

- the names and descriptions of the merged or acquired parties;
- the method of recognition of the merger or acquisition;

- the effective date of the merger or acquisition for reporting purposes; and
- any activities which the acquirer, as a result of the merger or acquisition, has decided to divest.

The information described in this paragraph 31.7 must also be included for mergers and acquisitions realised after the reporting date. If it is not practically feasible to provide this information, this must be disclosed as such (DAS 216.410).

31.7.2 Additional disclosure requirements for an acquisition

For an acquisition, the following additional disclosures should be included in the financial statements for the period in which the acquisition took place (DAS 216.402):

- the percentage of control acquired in the interest; and
- the purchase price of the acquisition or contingent purchase price obligations and a description thereof.

The disclosure of restructuring provisions related to the scaling down or termination of activities of the acquiree should comply with the requirements set out in DAS 252 (see Chapter 16). These restructuring provisions are considered a separate category for disclosure purposes (DAS 216.407).

If, in an acquisition at the end of an acquisition period, the fair values of the identifiable assets and liabilities or the purchase price can only be determined on an estimative basis, this should be disclosed and the reasons should be stated. When any adjustments to such provisional fair values are subsequently recognised, they should be disclosed in the financial statements for the period in which they are made (DAS 216.408).

31.7.3 Additional disclosure requirements for a pooling of interests

When applying the pooling of interests method, the following additional disclosures should be made in the year in which the merger is realised (DAS 216.409):

- description and number of shares issued, together with the percentages of voting shares of each of the companies exchanged in the merger;
- amounts of assets and liabilities belonging to each party at the beginning of the financial year. In fact, this refers to the balance sheet of the parties involved at the beginning of the financial year in which the pooling of interests took place; and
- revenue, other operating income, exceptional items and net income of the parties concerned for the financial year preceding the merger.

It is recommended that this information also be disclosed as at the date of the merger (regarding assets and liabilities) and for the period between the beginning of the financial year and the date of the merger (regarding profit or loss). Of course, this can only be done if the relevant information is available, i.e. if the parties involved have prepared interim figures as at the merger date (either internally or externally).

31.8 Exemptions for medium-sized and small entities

Medium-sized entities may, for mergers and acquisitions realised after the reporting date, suffice with the disclosure of subsequent events with important financial consequences pursuant to Article 2:380a NCC, stating the extent of those consequences (DAS 216.410).

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

31.9 Significant differences from IFRS

Recognition of mergers and acquisitions
IFRS 3 'Business Combinations' requires all acquisitions to be recognised using the acquisition method. The acquisition method is described as purchase accounting method in DAS 216. This means that an acquirer must be designated in all cases. DAS 216 classifies acquisitions as pooling of interests in exceptional cases. In those cases, recognition should be applied using the 'pooling of interests' method.

Concentration test
IFRS, unlike NL GAAP, has a voluntary concentration test (which can be applied on a per-acquisition basis) to determine whether a business is acquired or whether assets and liabilities are acquired. The concentration test consists of determining whether the fair value of the assets acquired is concentrated in a single identifiable asset (or in a group of similar identifiable assets). If this is the case, no business is acquired and IFRS 3 'Business Combinations' need not be applied. NL GAAP has no such test. In our view, the results of this concentration test can also be indicative under NL GAAP of whether a business is acquired or assets and liabilities are acquired.

Mergers and acquisitions under common control
Under DAS 216, all mergers and acquisitions under common control may be recognised using the pooling of interests method or carryover accounting. The purchase accounting method may only be applied if it does justice to the economic reality of the transaction. IFRS does not include provisions for recognising mergers and acquisitions under common control. The IASB is now, however, developing a standard in this area.

Determination of acquisition cost
IFRS 3 states that acquisition-related transaction costs are not considered part of the acquisition cost of the acquired company. The costs of issuing shares and costs of issuing loans are otherwise recognised in accordance with IAS 32 and IFRS 9. Under DAS 216, transaction costs are considered part of the acquisition cost. The costs of issuing shares may be recognised as part of the acquisition cost or recognised in accordance with DAS 290. The costs of issuing loans are recognised in accordance with DAS 290.

Criteria for recognising identified assets and liabilities
IFRS 3 requires identifiable assets and liabilities to be measured if the general definitions of assets and liabilities in the Framework are met. Identifiable assets and liabilities are measured at fair value on the acquisition date. The probability requirement is not an explicit criterion to be tested against. Under IFRS 3, identifiable assets and liabilities are further assumed to have sufficient information to determine their fair value in a reliable manner. DAS 216 states that identifiable assets and liabilities are measured only if the probability requirement is met and their fair value can be determined in a reliable manner. This leads in particular to differences in intangible fixed assets and contingent liabilities. Under DAS 216, these are not recognised if the probability requirement is not met. Under IFRS 3, these are recognised at fair value, even if future benefits or outflows of resources are not probable.

Restructuring costs after acquisition
Under IFRS 3, a restructuring provision is recognised as an identifiable liability only if the acquiree already has a restructuring obligation on the acquisition date (in accordance with IAS 37). DAS 216 conditionally allows the recognition of a restructuring provision arising from an acquisition, provided that the restructuring has been worked out in a detailed formal plan within three months (conditionally up to a maximum of six months) of the acquisition date and any resulting adjustment to the provision must be adjusted to (negative) goodwill.

Measurement of minority interest
Any minority interest (or 'non-controlling interest' under IFRS) is measured at the fair value of that minority interest separately or as the proportionate share of the fair value of the identifiable assets and liabilities acquired. IFRS 3 therefore allows any goodwill relating to the minority interest to be recognised as well ('full goodwill' method). DAS 216 does not allow a minority interest to be measured at fair value when recognising an acquisition. The minority interest should be recognised in accordance with DAS 216.213 for its proportionate share of the fair value of the identifiable assets and liabilities ('partial goodwill' method).

Classification of assets and liabilities acquired
IFRS 3 requires the classification of assets and liabilities acquired to be reconsidered in the event of an acquisition. This could include the classification of financial instruments in the 'fair value through profit and loss' category. IFRS 3 has two exceptions to this rule. The reconsideration need not take place for the classification of a lease (as an operating or finance lease) if the acquiring entity acts as lessor and for the classification of contracts as insurance contracts (IFRS 4). DAS 216 does not include such provisions.

Recognition of changes to initial recognition of the acquisition
IFRS 3 provides that initial recognition of the acquisition can be based on estimates. This is because final data may not yet be available. IFRS 3 stipulates that as long as the initial recognition is not final, estimates may only be adjusted if this results in a good representation of the actual situation as of the acquisition date. These adjustments are made during the measurement period. This period runs for up to 12 months after the acquisition date. In other

words, information that does not shed new light on the situation as of the acquisition date does not lead to an adjustment of the initial acquisition. After the end of the measurement period, no more adjustments to the recognition of the acquisition take place. Only in case of subsequent discovery of an error, error correction will take place in accordance with IAS 8. DAS 216 states that adjustments should be recognised in the initial recognition of the acquisition if:

- the adjustment does not result in an increase in the carrying amount to an amount greater than the recoverable amount; and
- such adjustment is made before the end of the first financial year that started after the acquisition.

Measurement of tax assets and liabilities
In the case of an acquisition, IFRS 3 prescribes that, in determining fair value, the deferred tax assets and liabilities acquired should be measured at face value. Under IFRS, measurement of deferred tax positions at present value is not allowed. DAS 216 allows both measurement at face value and present value.

Step acquisition
Under IFRS 3, the acquisition cost in the case of a step acquisition is not equal to the sum of the individual acquisition costs. After all, IFRS 3 provides that the originally held pre-acquisition interest is remeasured to fair value and forms part of the acquisition cost. The difference between the new fair value and the carrying amount of the original interest is recognised directly in the profit and loss account on the acquisition date, as if the interest previously held had been sold.

Under DAS 216, the acquisition cost of a step acquisition is the sum of the acquisition costs of the individual transactions. The fair values of the acquiree's identifiable assets and liabilities are then determined based on the dates on which each individual acquisition is recognised in the acquirer's financial statements. It is permissible to recognise the identifiable assets and liabilities of the original interest already held at fair value in an acquisition. Any adjustment of the identifiable assets and liabilities based on their fair value related to the interest already held is a revaluation and is recognised in accordance with Article 2:390 NCC. Incidentally, DAS 214.312 does state that the IFRS 3 recognition method included above should be followed in the company-only financial statements when applying combination 3.

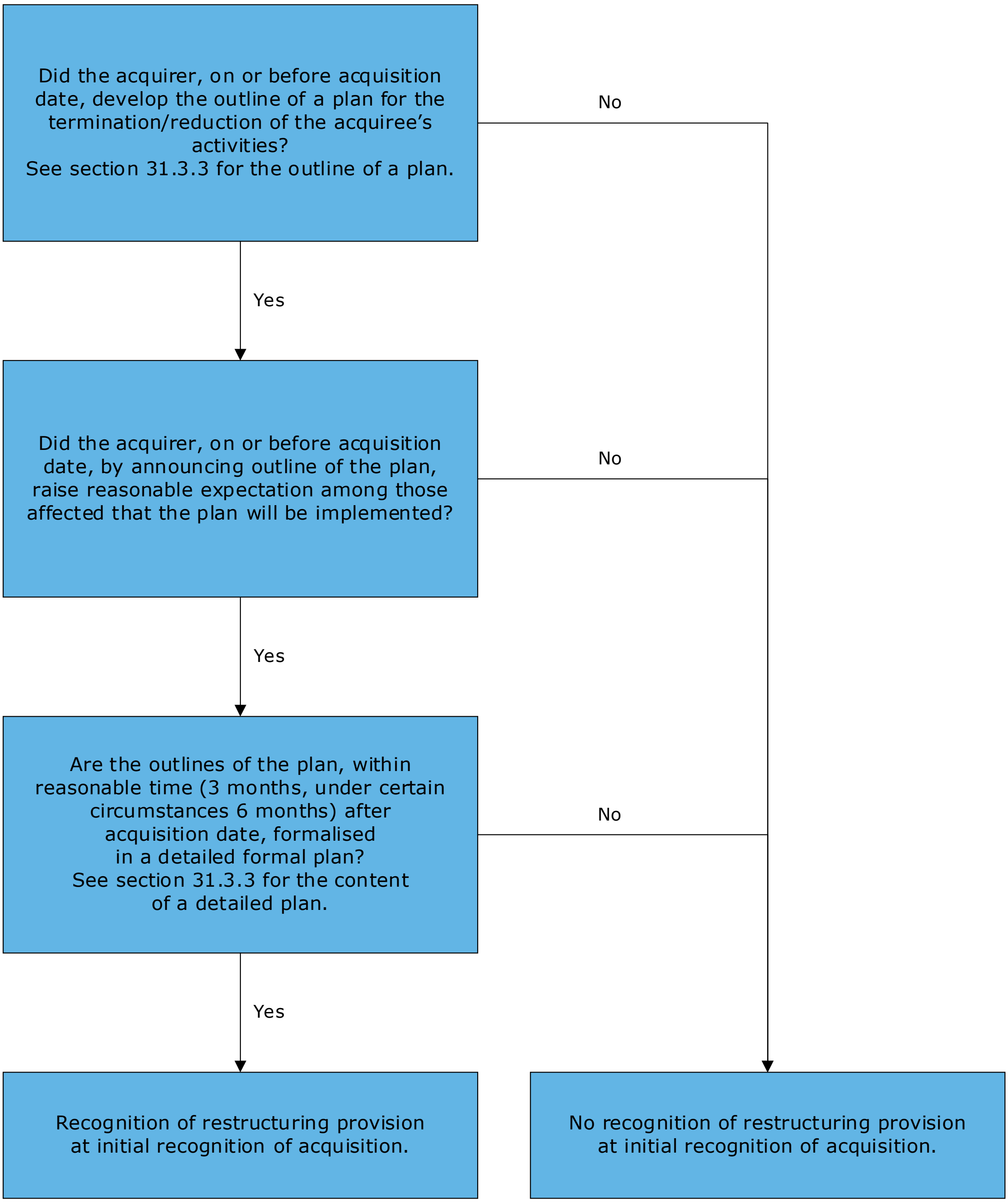
Changes in size of equity interests
IFRS 10 provides that changes in the size of equity interests in a subsidiary after control has been obtained and where the changes do not result in the loss of that control are recognised as transactions with shareholders within equity in the consolidated financial statements. This means that no profit or loss on these transactions can be realised in the consolidated financial statements. If control is lost, the remaining interest is remeasured to its fair value at that time. However, any profit or loss is then recognised in the consolidated profit and loss account. Under DAS 216 and DAS 217, there are no explicit provisions on this. This has the consequence that different recognition methods are possible. Incidentally,
DAS 214.312a/b does state that the IFRS 10 recognition method included above should be followed in the company-only financial statements when applying combination 3.

Contingent consideration as part of the acquisition cost
IFRS 3 states that changes in the fair value of a contingent consideration after acquisition may result from additional information about facts and circumstances on the acquisition date. These changes are recognised in accordance with the general provisions set out in paragraphs 45-50 of IFRS 3. However, if there are changes due to events after the acquisition date, such as the achievement of certain targets, these changes are recognised as follows:

- if the contingent consideration is classified as equity, the value is not adjusted. The future settlement will be recognised within the equity;
- if the contingent consideration is classified as an asset or liability and falls under IFRS 9 'Financial Instruments', the item will be measured at fair value with changes in the profit and loss account or other comprehensive income. If the contingent consideration is outside the scope of IFRS 9, it will be measured in accordance with IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' or another IFRS standard.

Under DAS 216, the acquirer recognises the purchase price adjustment as an adjustment to the acquisition cost and the resulting adjustment to (negative or positive) goodwill.

Annex 1. Diagram of the formation of a restructuring provision by the acquirer (DAS 216.212)



32 Legal merger, demerger and cross-border operations

32.1 Legal merger

32.1.1 Introduction

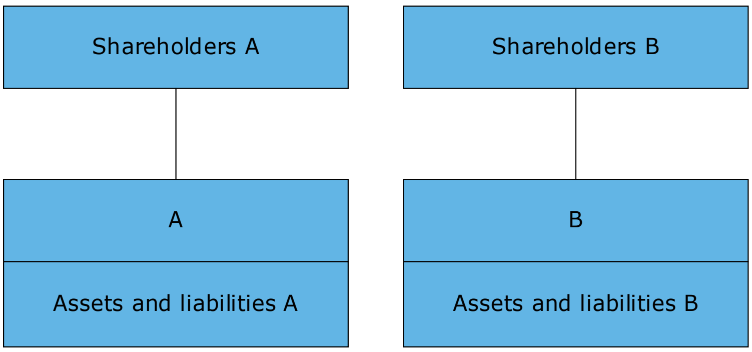
When entities combine, in either a merger or acquisition, a commonly used technique is the legal merger procedure. An important advantage of a legal merger is that the entity's assets are transferred by universal title to another entity. The advantage of a transfer by universal title is that there is no need to transfer each asset separately. As a result, legal mergers are not accompanied by transfer requirements (such as a notarial deed for property, notice to the debtor for claims, cooperation of the creditor for debts). For example, merging entities do not have to contact contracting parties or counterparties separately, such as creditors, to ascertain whether they agree to the transfer of the net assets.

Title 7 Book 2 NCC contains many mandatory provisions for legal mergers. Section 2 contains the general provisions on mergers (applicable to all mergers), Section 3 the specific provisions for mergers of public and private limited liability companies, and Section 3A the specific provisions for cross-border mergers.

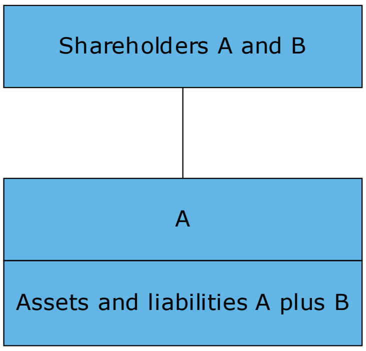
The provisions on mergers in Title 7 Book 2 NCC apply to associations (*vereniging*) (with full legal capacity), cooperatives (*coöperatie*), mutual guarantee associations (*onderlinge waarborgmaatschappij*), foundations (*stichting*), public limited liability entities (*naamloze vennootschap* (NV)) and private limited liability entities (*besloten vennootschap* (BV)). Title 7 Book 2 NCC also applies to any public limited liability entity, private limited liability entity or European cooperative entity that merges with a limited liability entity or cooperative entity incorporated governed by the law of another European Union or the European Economic Area (EEA) Member State (Article 2:308(3) NCC). In addition, these cross-border mergers are subject to specific provisions, which are set out in Section 3A and further clarified in paragraph 32.3.

A legal merger is the legal act of two or more entities whereby one of them (the acquiring entity) acquires the assets of the other (the entity ceasing to exist) by universal title. The acquiring entity is either an existing or a new entity created by the merger (Article 2:309 NCC). As a result of the merger, the disappearing entity ceases to exist. A merger is effected by notarial deed and takes effect from the day after the deed is executed. The acquiring entity is then deemed to be the entity that continues the integral legal status of its legal predecessor(s). It acquires all assets and liabilities of the entity or entities ceasing to exist. The bodies of the acquiring entity become directly responsible for performing the entity's obligations. The acquiring entity is responsible and liable for performing any existing obligations of the entities involved in the legal merger.

The following example serves to illustrate a legal merger. The situation prior to a legal merger is as follows:



Following the legal merger with BV A, a private limited liability entity, as the acquiring entity and BV B as the entity ceasing to exist, the situation is as follows:



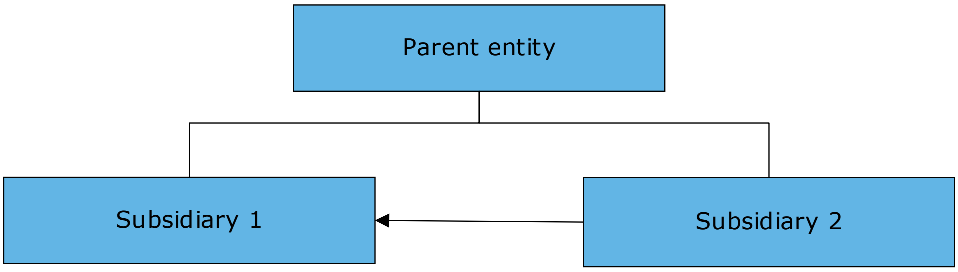
Options for a legal merger
The starting point for a legal merger is that the parties to it have the same legal form. Public and private limited liability entities are equated to each other in this regard. An acquiring entity newly created in a merger should also have the same legal form as the merging entities (Article 2:310(1) to (3) NCC). A so-called 'mixed merger' or 'cross merger' is also possible: an acquiring association, cooperative, mutual guarantee association or foundation may also merge with a public limited liability entity or private limited liability entity of which it is the sole shareholder, and an acquiring foundation, public limited liability entity or private limited liability entity may also merge with an association, cooperative or mutual guarantee association of which it is the sole member (Article 2:310(4) NCC).

Change of shareholding/membership
Apart from the acquiring entity, the merging entities cease to exist by operation of law when a legal merger takes effect (Article 2:311(1) NCC). In principle, the members or shareholders of the entity ceasing to exist become members or shareholders of the acquiring entity (by operation of law) as a result of the merger, except in the following instances (Article 2:311(2) NCC):

- in the case of a mixed merger or cross-merger (Article 2:310(4) NCC);
- if shares in the capital of the entities ceasing to exist are held by or on behalf of the merging entities, they lapse when the merger takes effect (Article 2:325(4) NCC);
- in a merger between an acquiring public limited liability entity and one or more private limited liability entities ceasing to exist, non-voting and non-participating shares in the latter expire when the merger takes effect. If no agreement is reached on the exchange ratio, the holders of these shares can apply to the company in writing for compensation for the loss of their shares (Article 2:330a NCC);
- in a so-called 'sister merger' (Article 2:333(2) NCC): a shareholder (natural person or legal person or parent entity) is the sole shareholder in the companies being merged;
- in the case of a 'parent-subsidiary merger' (Article 2:333(1) and (3) NCC): the acquiring entity or acquiring association, cooperative, mutual guarantee association or foundation merges with a company of which it is the sole shareholder;
- in a so-called 'triangular merger' (Article 2:333a NCC): the shareholders of the entity ceasing to exist become shareholders of a group entity of the acquiring entity. This is only possible if the group entity alone or together with another group entity holds 100% of the shares in the acquiring entity;
- in the case of a merger between an acquiring entity governed by the law of another EU or EEA Member State, the shareholders of the entity ceasing to exist who voted against the merger proposal and the holders of shares without voting rights may apply to the entity ceasing to exist for compensation. The shares in question lapse as soon as the merger takes effect (Article 2:333h(3) NCC);
- there is no right to a share on the basis of the share exchange ratio (Article 2:311(2) NCC).

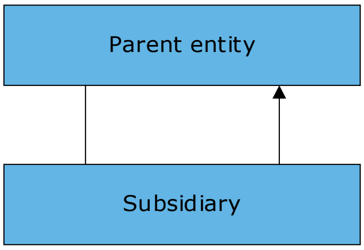
Sister merger and parent-subsidiary merger
A simplified procedure is available for sister and parent-subsidiary mergers (Article 2:333(1) and (2) NCC). The simplification of the procedure lies in the fact that a simpler merger proposal is sufficient. Specifically, it does not include details of the share exchange ratio (Article 2:326 NCC), the notes to the merger proposal are simpler (Article 2:327 NCC) and an auditor need not be involved (Article 2:328 NCC).

Illustration: sister merger



In this sister merger, subsidiary 1 is the acquiring entity and subsidiary 2 is the entity ceasing to exist. Both are private limited liability entities. The shareholder (parent) 'exchanges' its shares in subsidiary 2 for shares in subsidiary 1. If the parent is the sole shareholder of both merging subsidiaries, this sister merger means that subsidiary 2's share capital effectively ceases to exist as a result of the legal merger, as if the shares were cancelled (a capital reduction).

Illustration: parent-subsidiary merger



In this instance, the parent is the acquiring entity and the subsidiary the entity ceasing to exist. In a legal merger where the parent is the entity ceasing to exist and the subsidiary is the acquiring entity, however, the (simplified) procedure for parent-subsidiary mergers is not available. It is then treated as an 'ordinary' legal merger and not a parent-subsidiary merger.

32.1.2 Merger proposal

The management boards of the entities planning to merge are obliged to prepare a merger proposal, which must disclose at least (Article 2:312(2) NCC):

a. the legal forms, names and registered offices of the merging entities;
b. the articles of association of the acquiring entity, both in their present form and in their amended form after the merger. If the acquiring entity is incorporated upon the merger, the draft deed of incorporation should also be included;
c. any rights or benefits to be granted at the expense of the acquiring entity to any parties who have special rights vis-à-vis the entity ceasing to exist other than as members, such as the right to distribution of profit, and the date when this comes into effect;
d. any benefits to be granted to a management board or supervisory board member of a merging entity or to another party involved in the merger;
e. the post-merger composition of the management board and supervisory board, if any;
f. the date when the financial data of the entity ceasing to exist(s) are to be recognised in the acquiring entity's annual accounts;
g. the measures envisaged in connection with the transfer of membership or shareholding of the entity ceasing to exist;
h. intentions with regard to the continuation or termination of activities;
i. the name(s) of any party/parties who are required to approve the merger resolution.

A proposal for the merger of a public or private limited liability entity (not including parent-subsidiary and sister mergers) (Article 2:333(1) and (2) NCC) must also include (Article 2:326 NCC):

a. the exchange ratio of the shares and the amount(s) of any payments to be made in that regard;
b. the extent to which the shareholders of the entities ceasing to exist are to share in the profit of the acquiring entity and the date this will come into effect;
c. the number of shares that are to be cancelled, if any. These are shares held by either the acquiring entity or the entity ceasing to exist. The legal requirements for capital reduction do not apply to this;
d. the impact of the merger on holders of non-voting and non-participating shares;
e. the amount of compensation per share if Article 2:330a NCC applies;
f. the maximum amount of compensation that may be claimed if Article 2:330a NCC applies.

Date of recognition of financial data
The date when the entity ceasing to exist's financial data are to be recognised in the acquiring entity's financial statements must be stated in the merger proposal (Article 2:312(2)(f) NCC). Although no rules have been given for determining this date, failure to account for any particular period in financial statements should be avoided (balance sheet continuity). See also paragraph 32.1.3.

Exchange ratio
The merger proposal as regards a public or private limited liability entity must include Information on the exchange ratio (Article 2:312(2)(a) NCC). The notes to the merger proposal must disclose how the exchange ratio was determined (Article 2:327 NCC; see also paragraph 32.1.4. Among other things, an auditor must state whether, in its opinion, the proposed exchange ratio is reasonable (Article 2:328(1) NCC; see also paragraph 32.1.5). If there are listed shares in the capital of a merging company, the exchange ratio may depend on their stock exchange listing on one or more dates, prior to the date when the merger takes effect, to be specified in the merger proposal (Article 2:325(1) NCC).

Goodwill and distributable reserves
Unless the merging entities are associations or foundations, the merger proposal must also disclose the impact of the merger on the amount of goodwill and distributable reserves of the acquiring entity (Article 2:312(4) NCC). This may be disclosed in exact amounts; however, a rough indication of this impact may suffice if exact amounts are not yet known at the time the proposal is prepared.

Example: Goodwill and distributable reserves

Under a legal merger, A BV acquires 100% of the shares of B BV for 500,000 (estimated fair value of the shares of B) against the issue of its own shares with a face value of 150,000. A BV's equity therefore increases by 500,000. This is made up of 150,000 in share capital and 350,000 in share premium reserve. The fair value of the identified assets and liabilities (including tax effect) of B BV is 400,000. The amount of goodwill paid for is therefore USD 100.000. At the time of transfer, there are no legal reserves in B BV (Article 2:321(4) NCC) (see paragraph 32.1.3).

The merger proposal discloses the amount of 100,000 as the impact on goodwill. The impact on the size of distributable reserves is 350,000. This is the increase in the share premium reserve, which qualifies as a distributable reserve.

Signature of the merger proposal
The merger proposal must be signed by the management board members of each merging entity. Unless all merging entities are associations or foundations, the merger proposal must be approved by the supervisory boards and countersigned by the supervisory board members. If the signature of one or more management board and/or supervisory board members is lacking, this must be disclosed along with the reasons for that (Article 2:312(3) and (4) NCC).

32.1.3 Reporting issues arising from legal mergers

Last financial year of the entity ceasing to exist
The last financial year of the entity ceasing to exist ends on the date specified in the merger proposal. The acquiring entity recognises the financial data in its financial statements with effect from that date. This date is no later than the date when the deed of legal merger is signed (Article 2:321(1) NCC). In this regard, it is customary for the merger proposal to recognise the financial data of the entity ceasing to exist with effect from the beginning of its last financial year, e.g. 1 January of the financial year in which the merger is to take place. The legal merger does not actually take effect until the day after the merger deed has been executed, i.e. it is not retroactive. However, the point at which

the acquiring entity starts to include the figures of the entity ceasing to exist in its financial statements could well be before this merger date. One result of this is that it spares the entity ceasing to exist from having to prepare and publish financial statements for the last (in many cases short) financial year in which the legal merger takes effect.

Obligations for the entity ceasing to exist to prepare financial statements
The obligations for the entity ceasing to exist to prepare financial statements, for example in respect of financial years ended before the legal merger for which no financial statements have yet been prepared or adopted, are automatically the acquiring entity's responsibility following the legal merger (Article 2:321(2) NCC). Thus, the bodies of the acquiring entity are then also responsible for the proper satisfaction of these obligations. Exactly which bodies these are is not explicitly regulated by law. It is obvious that the management board will be responsible for any financial statements that have yet to be prepared.

Appointing an auditor and adopting the financial statements would seem to be a responsibility of the acquiring entity's general meeting, but the acquiring entity's management board could also exercise shareholder powers on that company's behalf.

If there are measurement differences between the last financial statements of the entity ceasing to exist and the first financial statements of the acquiring entity (see Chapter 31 in this regard), they must be explained in the latter financial statements (Article 2:321(3) NCC).

Any legal reserves that the entity ceasing to exist has recognised must similarly be recognised by the acquiring entity unless the legal basis for it has lapsed (Article 2:321(4) NCC). For example, if the entity ceasing to exist has capitalised development costs, the legal reserve required in this regard pursuant to Article 2:365(2) NCC will also be recognised by the acquiring entity, but not if those costs are not included on the acquiring entity's balance sheet. This could be the case where small entities merge, as they may choose not to capitalise development costs (DASsmall B1.105).

Application of Article 2:403 NCC
If the entity ceasing to exist is an entity to which Article 2:403 NCC was applied by the acquiring entity (parent entity), the situation with effect from the merger is that the entity ceasing to exist no longer exists and the acquiring entity is then the sole debtor of the entity ceasing to exist's creditors. Accordingly, Article 2:403 NCC then no longer applies. However, it is considered defensible to act in accordance with Article 2:403 NCC as regards the old financial statements. If the acquiring entity is not the entity ceasing to exist's parent entity, then it is very likely that it will revoke the declaration of liability pursuant to Article 2:403 NCC in accordance with Article 2:404 NCC, thus terminating its so-called residual liability. Since the exemption under Article 2:403 is then no longer available, for the added reason that there is no longer a group link, all requirements of Title 9 Book 2 NCC will still have to be met.

Interim statement of assets and liabilities
If when filing the merger proposal with the Trade Register more than six months have elapsed since the last financial year for which the entity ceasing to exist's annual or other financial statements were adopted, the management board must prepare financial statements or an interim statement of assets and liabilities. This interim statement of assets and liabilities reflects the situation that applies at a time not earlier than the first day of the third month before the month in which the merger proposal is filed with the Trade Register. In this way, the interim statement of assets and liabilities is still fairly recent. In any case, not older than 4 months before the time of filing the merger proposal. It should be prepared with due observance of the presentation and measurement methods applied in the most recently adopted annual or other financial statements. If the current value differs significantly from the carrying amount, the current value may be assumed on that basis if justified. The statement of assets and liabilities must also include the amounts to be reserved by law or under the articles of association (Article 2:313(2) NCC). Entities that meet the requirements for six monthly financial reporting provided by Section 5:25d of the Financial Supervision Act (*Wet op het financieel toezicht*, Wft) are not required to prepare an interim statement of assets and liabilities (Article 2:313(5) NCC).

Example: Interim statement of assets and liabilities in the case of a legal merger

If the entity ceasing to exist's financial year coincides with the calendar year and its financial statements for year 1 have been adopted with the merger proposal being filed in the first six months of year 2 (e.g. on 15 May), no interim statement of assets and liabilities is required.

If more than six months have elapsed since the financial year for which the entity ceasing to exist's financial statements have been adopted (e.g. in the event that the merger proposal is filed on 30 September), then financial statements or an interim statement of assets and liabilities must be drawn up to reflect the state of assets and liabilities as at 1 June at the earliest.

Accounting treatment of legal mergers

Legal mergers under common control
See paragraph 31.6 for the accounting treatments available for legal mergers under common control.

If carryover accounting is chosen for a legal merger under joint management and the time specified in the merger proposal for inclusion of the entity ceasing to exist's figures in the acquiring entity's financial statements precedes the merger date, we consider it acceptable to apply merger accounting from that time.

At first glance, the recognition methods listed in DAS 216.503 for mergers and acquisitions under common control (the purchase accounting method, the pooling of interest method and the carryover accounting method) appear to exclude this method of recognition. However, we feel certain that the Dutch Accounting Standards Board issued DAS 216.503 to provide support for the practice of recognising transactions not previously covered by the Dutch Accounting Standards rather than to curtail the existing practice. According to the Introduction (*Ten Geleide*) to the 2013 annual edition, mentioning of these three possibilities provides clarity to the practice. In our view, pursuing balance sheet continuity and allowing carryover accounting as of the date when the acquiring entity incorporates the data of the entity ceasing to exist contributes in every way to the legal requirement to provide an insight into equity and profit or loss in a situation under common control that has not been addressed by the legislator.

Example: Application of carryover accounting in a legal merger under common control

Company A and Company B are both subsidiaries of the same parent entity. A and B merge on 1 June of year 2, A being the acquiring entity and B the entity ceasing to exist. A uses the carryover accounting method for the merger. According to the merger proposal and merger deed, B's financial information must be included in A's financial statements with effect from 1 January of year 2. In determining the acquisition date, A wishes to use this date (instead of the merger date of 1 June in year 2) as its starting point.

A recognises the carrying amounts of B's assets and liabilities as at 1 January of year 2. The comparative figures for year 1 are not adjusted.

Other legal mergers
Other legal mergers are accounted for using either the purchase accounting method or the pooling of interests method. See paragraph 31.2 for a description of these methods and the circumstances in which they are applied.

The merger date and the end of the last financial year of the entity ceasing to exist are different
A special situation arises if the purchase accounting method is used for a legal merger and the merger date and the date that the acquiring entity uses for inclusion of the financial information of the entity ceasing to exist in its financial statements are not the same.

Example: The merger date and the end of the last financial year of the entity ceasing to exist are different

A BV establishes Newco BV to acquire B BV. The acquisition takes effect on 30 June of year 2 and the purchase accounting method is used for it. Immediately after the acquisition, i.e. on 1 July of year 2, Newco and B merge, Newco being the acquiring entity and B the entity ceasing to exist. According to the merger deed, B's figures must be included in Newco's financial statements from 1 January of year 2. B's last financial year therefore ends on 31 December of year 1.

The question is then how Newco should recognise B's figures for the first half of year 2. The fact is that the acquisition date is 30 June of that year. As of that date, based on the purchase accounting method, Newco must recognise identifiable assets and liabilities at fair value. Newco, the acquiring party, should only recognise income and expenses of entity ceasing to exist B in its profit and loss account from that date. Under the purchase accounting method, the acquisition may not be accounted for 'retrospectively'. The legal position, however, is that Newco must indeed include B's figures for the first half of the year in its financial statements. The solution to this is for Newco's year 2 financial statements to demerger the figures for the first half and second half of the year, accompanied by adequate notes.

The first half of the year then effectively includes the figures from the continuation of B's operations up to the point that B is acquired. Newco's opening balance sheet on 1 January of year 2 therefore matches B's closing balance sheet on 31 December of year 1. On the acquisition date (30 June of year 2), Newco is the acquiring entity of B (as an extension of A) and B's closing balance sheet under the old owner (i.e. on 30 June of year 2) is reconciled to the acquisition balance sheet, which lists the fair value of B's identifiable assets and liabilities and goodwill paid separately. Any goodwill that B still had on the balance sheet from its own acquisitions is removed, as this goodwill is not an identifiable asset for A or Newco. A and Newco determine goodwill when acquiring B in the customary way (the difference between the acquisition price and the fair value of identifiable assets less liabilities). The movement schedules (such as for equity) should also clearly show the effects of the acquisition. The columns in the profit and loss account are clearly separated using headings such as 'before acquisition' and 'after acquisition'. These terms are also used in the notes.

Although this is an unusual solution, it is in line with DAS 216 regarding the purchase accounting method and it also complies with the legal requirement to include figures for the first half year and ensure balance sheet continuity.

This problem does not arise with the pooling of interests method, as it treats the merger as an established fact from the beginning of the financial year. The same goes for the presentation of comparative figures in the financial statements. The profit and loss account showing the income and expenses for year 2 and year 1 then states the income and expenses of the combination as if it had already been effected at the beginning of year 1.

32.1.4 Notes to the merger proposal

In addition to the merger proposal, the management boards of the merging entities must prepare written notes to it. These notes should disclose the reason for the merger, the expected impact of the merger on operations and an explanation from a legal, economic and social point of view (Article 2:313(1) NCC). These notes are not required if the members or shareholders of the merging entities agree (Article 2:313(4) NCC). This requires approval from all members or shareholders.

In the case of a public or private limited liability entity, the management board must also disclose the following in the notes to a merger proposal (Article 2:327 NCC):

- the method(s) used to determine the share exchange ratio;
- whether this/these method(s) are appropriate in the particular instance;
- the valuation resulting from each method applied;
- if more than one method has been used, whether the relative importance attributed to the valuation methods used may be considered as generally acceptable; and
- whether there have been any particular difficulties with such valuation and with the determination of the exchange ratio.

32.1.5 Auditor's report

In the case of a legal merger of a public or private limited liability entity, an auditor appointed by the management board must (Article 2:328 NCC):

- examine and state whether, in their opinion, the share exchange ratio is reasonable. If the auditor considers that it is not reasonable, this generally results in consultations on whether or not to adjust the exchange ratio. It should be noted that a negative opinion does not prevent the merger from being effected. In that case, it is up to the shareholders whether they still wish to effect the merger based on the proposed exchange ratio irrespective of the auditor's adverse opinion;
- if the acquiring entity is a public limited liability entity, state, just as in the case of a payment (contribution) on shares in kind (not in cash), that the sum of the equity of the entities ceasing to exist on the date to which the financial statements or the interim statement of assets and liabilities relates is at least equal to the notional amount to be paid up on the aggregate number of shares to be acquired increased with cash payments as well as with the total amount of the compensation which shareholders may claim in certain instances (as described in Article 2:330a NCC). This entails a capital protection requirement. The purpose of the auditor's report is to ensure that the shares allocated have been paid up in full against the reserves, which have been increased by the transfer of the net assets. A capital shortfall on the part of the entities ceasing to exist need not be problematic as long as the sum of all net assets exceeds the required minimum. If the auditor is unable to issue this report, the merger proposal will have to be amended; and
- prepare a report setting out the auditor's opinion on the disclosures in the notes to the merger proposal relating to the method(s) used to determine the exchange ratio.

Exemptions
The auditor's report regarding the exchange ratio and the report on the method used to determine the exchange ratio are not required if all shareholders of the merging companies agree (Article 2:328(6) NCC). These documents as well as the auditor’s report accompanying the sum of the equity of the entity ceasing to exist are also not required if (Article 2:333 NCC):

- the acquiring public or private limited liability entity is the sole shareholder of the public or private limited liability entity ceasing to exist;
- the acquiring public or private limited liability entity is the sole member of the association, cooperative or mutual guarantee association ceasing to exist;
- the shares of the acquiring public or private limited liability entity and those of the public or private limited liability entity ceasing to exist are directly or indirectly held by one natural person or entity and the acquiring entity does not issue shares; or
- the acquiring association, cooperative, mutual guarantee association or foundation is the sole shareholder of the public or private limited liability entity ceasing to exist.

In such instances, the additional requirements for a public or private limited liability entity regarding the content of the merger proposal (Article 2:326 NCC) and the management board disclosures accompanying the merger proposal (Article 2:327 NCC) do not apply.

More than one auditor
If an auditor's report and a report on the exchange ratio are required, the management board of each company involved in the merger must appoint an auditor. The management boards may decide to jointly appoint one auditor. If two or more public limited liability entities are involved in the merger, the principle is that each management board appoints its own auditor, and all the auditors involved work independently of each other. The purpose of this provision is to safeguard the interests of minority shareholders by having the reasonableness of the exchange ratio assessed by different auditors working independently of each other. The approval of the Enterprise Chamber is required for the appointment of a single auditor (Article 2:328(3) NCC).

If more than one auditor is appointed, the auditor’s report accompanying the sum of the equity of the entities ceasing to exist only needs to be issued by the auditor acting on behalf of the acquiring entity.

32.1.6 Publication of the merger documents

Trade Register
Each merging entity must file at the office of the Trade Register (Article 2:314(1) NCC):

- the merger proposal;

- the last three adopted annual or other financial statements of the merging entities together with (if they have been audited) the auditors' report in that regard, insofar as those statements are required to be available for inspection;
- the management board reports of the merging entities for the last three completed years insofar as they are or are required to be available for inspection;
- interim statements of assets and liabilities or financial statements that have not been adopted insofar as they are required pursuant to Article 2:313(2) NCC and insofar as the financial statements of the entity in question are required to be available for inspection;
- for public and private limited liability entities: the auditor's report as to the reasonableness of the exchange ratio and the statement of assets and liabilities (Article 2:328(5) NCC).

Availability for inspection at the entity's office
When the documents are filed with Trade Register, the management board(s) in question must make them as well as its/their notes to the merger proposal available for inspection at the office(s) of its own entity/entities (Article 2:314(2) NCC). Annual or other financial statements and management board reports that are not required to be publicly available for inspection (e.g. in the case of associations) as well as any written opinion or comments submitted by the works council, participation council or association of employees. must also be made available for inspection at the entity in question. If the entity does not have its own office, these documents must be made available to a management board member for inspection. They may also be made accessible by electronic means. It should be noted that these obligations do not apply to foundations (Article 2:314 NCC). Public and private limited liability entities must also make the auditor's report available for inspection (Article 2:328(5) NCC).

The documents must be available for inspection or accessible by electronic means for six months after the merger. The persons entitled to inspect them are (Articles 2:314(2) and 329 NCC):

- shareholders or members;
- holders of a special right vis-à-vis the entity in question, such as a right to a distribution of profit or to subscribe for shares;
- holders of depositary receipts for its shares issued with the cooperation of a public limited liability entity; and
- any holder of meeting rights in a private limited liability entity pursuant to Article 2:227(2) NCC. Besides shareholders, these are holders of depositary receipts who have meeting rights under the articles of association, shareholders who do not have voting rights due to a usufruct or pledge, and usufructuaries and pledgees who do have voting rights.

Persons entitled to inspect these documents may obtain copies of them free of charge for as long as they are available for inspection or accessible by electronic means. Electronic copies may be provided with the consent of a member or shareholder. The entity is not required to provide copies if members or shareholders are able to store them electronically.

Announcement in a daily newspaper
After the documents specified by the law have been filed with the Trade Register and are available for inspection at the office of the entity in question, the merging entities must announce in a national daily newspaper that these documents are available for inspection or can be accessed electronically, stating the address (Article 2:314(3) NCC). If the merger proposal is amended, the documents referred to above must be filed again and a new announcement that they are available for inspection must be published (Article 2:314(5) NCC).

Change in assets and liabilities
The management board of each merging entity is obliged to inform the general meeting and the other merging entities of any material changes in assets and liabilities appearing after the merger proposal and which affect the disclosures made in the merger proposal or the notes to them. This is not required if the members or shareholders of the merging entities agree (Article 2:315 NCC).

32.1.7 Completion of a legal merger

Guarantee to creditors
Any creditor of the entities involved in the merger may require at least one of these entities to provide security or another guarantee for the satisfaction of its claim. This is not necessary if that creditor already has sufficient guarantees, or if the assets of the acquiring entity after the merger provide no less guarantee for the payment of its

claim than before the merger. If no guarantee is given, opposition proceedings filed against the merger proposal (see below) could succeed (Article 2:316(1) NCC).

Possibility of opposition by creditors
The obligation to make the documents prescribed by law available for inspection at the Trade Register is intended to protect the merging entities' creditors. Creditors may bring opposition proceedings before the District Court within one month of the announcement that the merger documents have been filed, specifying the security they are seeking. They must then make a plausible case that the assets of the acquiring entity after the merger will provide less security for the satisfaction of their claims than previously, and that they have not obtained adequate guarantees (Article 2:316(2) NCC). If opposition proceedings are filed on time, the merger deed may only be executed if the opposition is withdrawn or the lifting of the opposition has become enforceable (Article 2:316(4) NCC). If the merger deed has already been executed, the court may, if an appeal is filed against that, order the provision of such security as it may determine and attach a penalty to that (Article 2:316(5) NCC). If the lifting of the opposition is set aside on appeal or in cassation appeal proceedings, the merger may already be in effect, meaning that the opposition as such is no longer of any benefit. For this reason, the rule is that the creditor can still obtain security or another guarantee if that is the case.

Merger resolution
A legal merger generally entails a change in the entity's structure. Therefore, the entity's highest ranking body, the general meeting, is authorised to adopt the resolution to merge. In a foundation, any party authorised to amend the articles of association, or alternatively the management board, adopts this resolution (Article 2:317(1) NCC); this resolution requires the District Court's approval unless the articles of association provide for the possibility to alter all of its provisions (Article 2:317(5) NCC).

The rule regarding the power to adopt the merger resolution is generally in line with the rule regarding amendments to the articles of association. A resolution to merge must be adopted in the same way as a resolution to amend the articles of association, unless the articles of association include different provisions regarding merger resolutions. If the law requires the consent of all or certain shareholders for a resolution to amend the articles of association, the same applies to the merger resolution (Article 2:317(3) and (4) NCC).

The merger resolution may not differ from the merger proposal (Article 2:317(1) NCC). If there is any change, the procedure prior to the merger resolution has to be gone through again. The merger resolution may only be adopted one month after the date when all merging entities have announced the filing of the merger proposal (Article 2:317(2) NCC). This period makes it possible for creditors to oppose the merger proposal.

Unless the articles of association provide otherwise, an acquiring public or private limited liability entity may decide to merge by a management board resolution. Such a resolution may only be adopted if the company has disclosed its intention to adopt this course of action in its announcement that the merger proposal has been filed. Shareholders representing at least 20% of the issued capital can block this resolution. They must then ask the management board, within one month following the date of the announcement, to convene a general meeting to adopt a resolution on the merger. In the case of a parent-subsidiary merger, i.e. where an acquiring entity merges with a company of which it is the sole shareholder, the entity ceasing to exist may also decide to merge by a management board resolution, unless the articles of association provide otherwise (Article 2:331 NCC).

Effectuation of the merger
The merger is effected with the execution of a notarial deed (Article 2:318(1) NCC). This deed creates rights. In it, the entities concerned state their intention to effect a legal merger. The contents of the merger proposal may be inserted or attached to it. The merger takes effect the day after deed is executed (at midnight).

The civil-law notary assesses whether the formal requirements by law and under the articles of association have been complied with, and certifies this at the foot of the deed (Article 2:318(2) NCC).

The day after this deed is executed, the transfer by universal title of the net assets of the entity ceasing to exist(s) to the acquiring entity is thus an established fact. The merging entities, not including the acquiring entity, cease to exist with the merger's entry into force (Article 2:311(1) NCC). The deed may only be executed within six months of the announcement of the filing of the proposal or, if this is not allowed due to opposition lodged, within one month after it has been withdrawn or its lifting has become enforceable (Article 2:318(1) NCC). Therefore, this six-month period may only be extended if opposition proceedings have been filed, but is limited to one month after the opposition has been withdrawn or after its lifting has become enforceable.

Registration of the merger in the Trade Register and other public registers
The acquiring entity must register the merger in the Trade Register where each merged entity and itself are registered within eight days of the execution of the deed. As part of this registration, a copy of the merger deed with the notarial declaration at the foot of it must be filed at the office of the Trade Register (Article 2:318(3) NCC). The acquiring entity must, within one month, notify the other public registers in which any transfer of rights or the merger may be registered (Article 2:318(4) NCC).

32.2 Legal demerger

32.2.1 Introduction

The legal method used to effect legal demergers is being used increasingly. A legal demerger is the opposite of a legal merger. An important advantage of a demerger is that it allows a company to be divided into different parts, with some or all of its net assets being transferred by universal title to one or more other entities. One consequence of a transfer by universal title is that separate acts of transfer are not required for each asset. As a result, a legal demerger is not encumbered by transfer formalities, meaning that the demerging entity does not need to contact each contracting or counterparty separately, such as creditors, to ascertain whether they agree to the transfer of the asset and liabilities.

Title 7 Book 2 NCC contains many mandatory provisions on legal demergers. Section 4 contains the general provisions on demergers (applicable to all demergers), Section 5 the specific provisions on demergers in which a public limited liability entity or private limited liability entity is demerged or established, and Section 6 the specific provisions for cross-border demergers.

The provisions on demergers in Title 7 Book 2 NCC apply to the association (with full legal capacity), the cooperative, the mutual guarantee association, the foundation, the public limited liability entity and the private limited liability entity. Title 7 Book 2 NCC also applies to a demerging public limited liability entity or private limited liability entity if by the demerger one or more limited liability entities that have share capital are established under the law of a different EU or EEA member state and applies to a public limited liability entity or private limited liability entity established as acquiring entity by a demerger of an entity that has share capital governed by the law of a different EU or EEA member state (Article 2:308 (4) NCC). In addition, these cross-border demergers are subject to specific provisions, which are set out in Section 6 and clarified in more detail in paragraph 32.3.

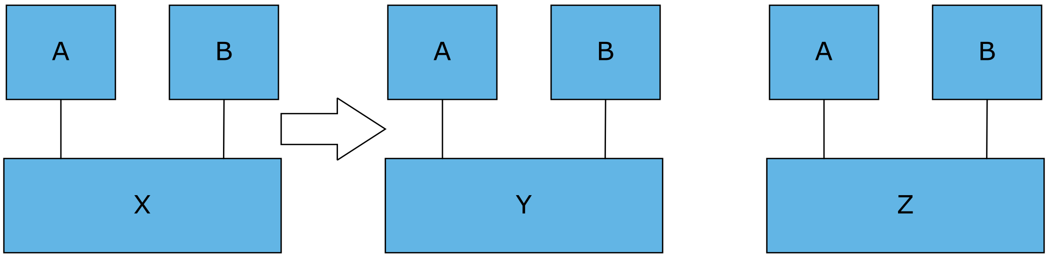
Dutch law distinguishes between:

a. absolute demergers (‘zuivere splitsing’) (Article 2:334a(2) NCC); and
b. and separations (‘afsplitsing’) (Article 2:334a(3) NCC).

Absolute demerger (‘zuivere splitsing’)
An absolute demerger is the legal act by which the assets and liabilities of an entity that ceases to exist upon a demerger are acquired by two or more other entities under universal title in accordance with the description attached to the deed of demerger.

In the following example of an absolute demerger, BV X is demerged to form BV Y and BV Z. After this legal demerger, BV X ceases to exist and its shareholders (A and B) will become shareholders in both BV Y and BV Z.

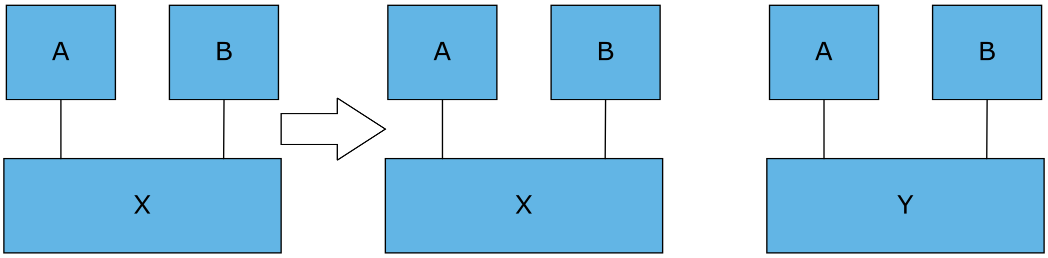
Illustration: absolute demerger



Separation ('afsplitsing')
A separation is the legal act by which some or all of the net assets of an entity that does not cease to exist upon demerger are acquired by one or more other entities, under universal title in accordance with the description attached to the deed of separation, at least one of which grants membership rights or shares in its capital to the members or shareholders of the spinning off entity, or at least one of which is established by the separating entity upon that separation.

In the following example of a separation, part of BV X is separated to form BV Y. After the legal separation, BV X continues to exist and its shareholders (A and B) retain their shares in BV X and acquire shares in BV Y.

Illustration: separation



Change of shareholding/membership
In principle, members or shareholders of the demerging entity automatically become members or shareholders of all acquiring entities (Article 2:334e(1) NCC), except in the following instances (Article 2:334e(1) and (2) NCC):

- no shares in the capital of a demerging entity are acquired for shares in the capital of the demerging company that are held by or for the account of either the acquiring entity or the demerging entity;
- the acquiring entities in the demerger are incorporated public and private limited liability entities and the demerging entity acquires all the shares in them with the demerger;
- in the event of a 'rancorous' or 'three-way' demerger ('ruziesplitsing' of 'driehoekssplitsing');
- the share exchange ratio does not provide entitlement to any shares;
- if the acquiring entity is a public limited liability entity, non-voting and non-participating shares in any private limited liability entity expire when the demerger becomes effective. If no agreement is reached on the exchange ratio, the holders of these shares can apply to the entity in writing for compensation for the loss of their shares (Article 2:334ee1 NCC).

32.2.2 Procedures

Differences in the procedure for a legal demerger compared to a legal merger
In the case of a demerger, the position of creditors, shareholders, members, employees and other counterparties of parties to the demerger deserves particular attention. Unlike in legal mergers, where the joint creditors have recourse to the joint assets of the merging entities, in demergers they have to deal with debtors, whether new or ongoing 'old' ones, who own just some of the original assets of the demerging entity. The fact is that, in a demerger, either some or all of the net assets are transferred to one or more acquiring entities. Therefore, compared to the merger procedure, the demerger procedure has a number of additional safeguards. The description to be attached to the deed of demerger, for example, must specify which assets will be transferred to which entity and which assets will

remain with the demerging entity. This should include the value of the sum of those assets that each entity acquires or retains.

The assets acquired or retained by an entity must be at least zero. In principle, a legal relationship should be transferred in its entirety. A legal relationship associated with different assets may be transferred to different acquiring entities on a demerged basis. In principle, if activities are demerged or separated, any capitalised goodwill relating to those activities must also be demerged or separated in the same way. After all, activities and the goodwill paid for them cannot be divided among different companies. This is because goodwill is inextricably linked to the activities in question and is not a separate asset.

In a demerger, the demerged entity which continues to exist and the acquiring entities are jointly liable for the performance of the demerged entity's obligations at the time of the demerger. In principle, a bankrupt entity or one that has been granted a suspension of payments may not demerge. This is only allowed if all acquiring entities are public and/or private limited liability entities incorporated at the time of the demerger and the demerged entity acquires all shares at the time of the demerger.

Parties to the demerger are the demerging entity as well as every acquiring entity, with the exception of entities incorporated upon the demerger (Article 2:334a(4) NCC). Who qualifies as a party to the demerger is important for the applicability of certain sections of the law at several stages of the demerger procedure.

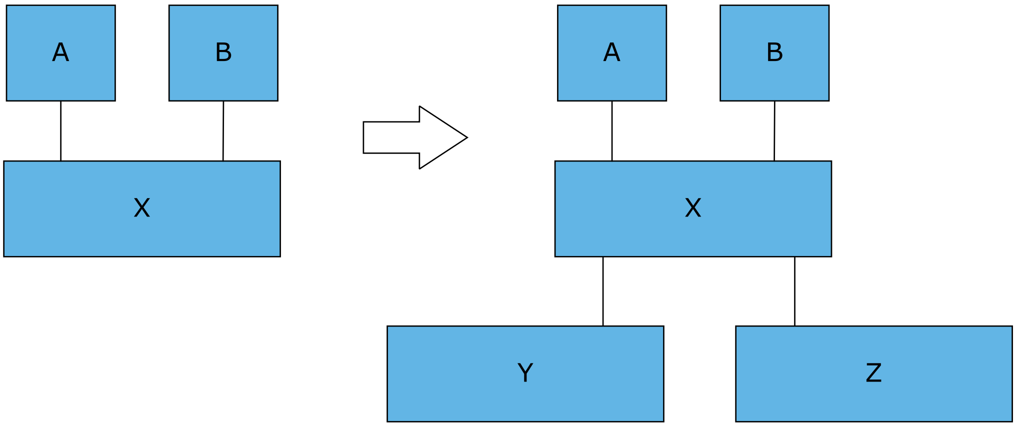
Stages in the effectuation of a legal demerger
There are four stages:

- the preparation of the demerger, in which the management board conceives and publishes a demerger proposal;
- the demerger resolution, adopted by the entity's authorised body;
- the demerger itself, i.e. the execution of the notarial deed of demerger by the civil-law notary;
- effectuation of the demerger and the implementing acts, such as recording the transfer of assets of registered property in the appropriate public registers.

Opportunities for demerger
The starting point for a legal demerger is that the parties to it have the same legal form. Public and private limited liability entities are equated to each other in this regard. An acquiring entity newly incorporated at the time of demerger must also have the same legal form as the demerging entity (Article 2:334b(1) to (3) NCC). An exception to this may be allowed in the case of a 'parent-subsidiary demerger', also referred to as a group demerger. This is the case if all acquiring entities are incorporated at the time of the demerger and the demerging entity becomes their sole shareholder at the time of the demerger. When an association, cooperative, mutual guarantee association or foundation demerges, one or more public or private limited liability entities may be incorporated, provided that the demerging entity acquires all the shares in it upon the demerger (Article 2:334b(4) NCC). This is also a form of demerger, because the demerging entity (which acquires the shares) continues to exist.

In the following example of a parent-subsidiary demerger, two divisions of BV X are separated into the BVs Y and Z, which have yet to be incorporated. After this, X continues to exist and, as the parent entity, it acquires all the shares in BV Y and BV Z.

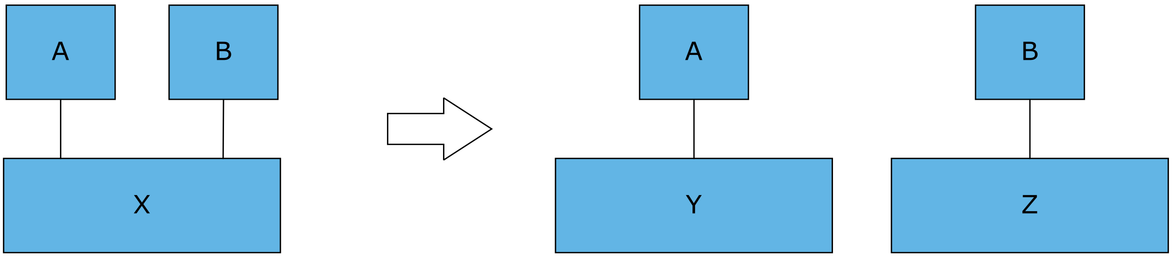
Illustration: parent-subsidiary demerger



There is also a special form of an absolute demerger (zuivere splitsing), specifically a rancorous demerger (ruziesplitsing), in which the shareholders of the demerging entity separately become shareholders of the respective acquiring entities (Article 2:334cc NCC).

In the following example of a rancorous demerger, A and B hold all the shares in BV X. BV X undergoes an absolute demerger into two entities: BV Y and BV Z, with BV X ceasing to exist upon the demerger. Shareholder A becomes the sole shareholder of BV Y shareholder B becomes the sole shareholder of BV Z.

Illustration: rancorous demerger



There is also a 'three-way' demerger (driehoekssplitsing). This is the case if, according to the deed of demerger, a group entity of the acquiring entity, alone or together with other group entities, provides the entire issued capital of the acquiring entity, and the shareholders of the demerging company become shareholders of this group entity (Article 2:334ii NCC).

The law contains some exemptions for so-called proportional demergers. A proportional demerger is the situation in which all companies are created at the time of the demerger and the shareholders of the demerging company become shareholders of those companies in proportion to their share in the demerging company. In this situation, the interests of the various shareholders do not change and the demerger is therefore subject to certain exemptions. The following requirements then no longer apply: the drafting of written notes to the demerger proposal, the preparation of financial statements or an interim statement of assets and liabilities if more than six months have elapsed since the last financial year, the disclosure of information on significant changes that become apparent after the demerger proposal, the disclosure of additional information in the demerger proposal if it involves the demerger or incorporation of a public or private limited liability entity, the audit and (in the case of a public limited liability entity) certain rules regarding non-cash contributions (Article 2:334hh(2) NCC).

Bankruptcy demerger
An entity may not be a party to a demerger if it is bankrupt or if it has been granted a suspension of payments. Nor may a dissolved entity be a party to a demerger if a distribution has already been made pursuant to its liquidation. A demerging entity may, however, be bankrupt or under the suspension of payments regime if all the acquiring entities at the time of demerger are incorporated public or private limited liability entities and the demerging entity becomes their sole shareholder upon the demerger. If the demerging entity is bankrupt, the receiver is entitled to demerge it.

This facility is known as a 'bankruptcy demerger', and the receiver may use it to separate viable parts of the bankrupt entity. An authorised demerger of a bankrupt entity or an entity subject to the suspension of payments regime is exempt from certain regulations (Article 2:334b NCC).

Capital protection
For acquiring entities (with the exclusion of public and private limited liability entities), the value of the portion of the demerging entity's assets and liabilities acquired by each acquiring entity must be at least zero at the time of the demerger. Consequently, these acquiring entities may not acquire negative net assets. Similarly, the value of the portion of the assets and liabilities retained by a demerging entity that continues to exist (excluding public and private limited liability entities) plus the value of shares in the capital of acquiring entities that it acquires upon the demerger must be at least zero (Article 2:334d NCC).

The determining factor for calculating this 'at least zero value' is the reference date of the financial statements or interim statement of assets and liabilities that must accompany the demerger proposal. These values should be calculated using the same measurement methods applied in the annual accounts or (if applicable) interim statement of assets and liabilities that the demerging entities are required to prepare for the demerger proposal.

The value of the portion of the assets retained by a demerging public limited liability entity that continues to exist plus the value of the shares in the capital of the acquiring entities that it acquires upon the demerger must correspond at least to the paid-up and called-up part of the capital plus the reserves that the public or private limited liability entity is required to hold immediately after the demerger by law or by its articles of association (Article 2:334w NCC). This provision does not apply to parent-subsidiary demergers (Article 2:334h(1) NCC). For an acquiring public limited liability entity, the same rules apply as in the case of a full payment of shares by contribution in kind (Articles 2:94a and 2:94b NCC).

The legislator wanted to prevent assets from being separated in such a way that liabilities exceed assets or a separated entity that continues to exist is left with nothing but debts. The management boards of the parties to the demerger are obliged to ensure that these requirements are met.

32.2.3 Demerger proposal

The management board of the parties to a demerger are required to draw up a demerger proposal (Article 2:334f(1) NCC). These are the management boards of the demerging entity and the acquiring entities, unless the acquiring entities are incorporated upon the demerger (Article 2:334a(4) NCC). Therefore, there has to be a single demerger proposal, even if there are multiple parties to the demerger.

The demerger proposal should at least disclose (Article 2:334f(2) NCC):

a. the legal form, name and registered office of the parties to the demerger and of any acquiring entities incorporated upon the demerger;
b. the articles of association of the acquiring entities and of the demerging entity which continues to exist, both in their current form and in their amended form after the demerger. If entities are incorporated upon the demerger, the draft instrument of incorporation should also be included;
c. whether all or some of the assets and liabilities of the demerging entity are to be transferred;
d. a description making it possible to determine precisely which assets and liabilities of the demerging entity are to be transferred to each of the acquiring entities and, if not all of its assets and liabilities are to be transferred, which assets and liabilities it will retain, as well as a *pro forma* profit and loss account or statement of income of the acquiring entities and any demerging entities that continue to exist;
e. the value of the assets and liabilities to be acquired by each acquiring entity and of those assets retained by the demerging entity which continues to exist, as well as the value of shares in the capital of acquiring entities to be acquired by the demerging entity which continues to exist upon the demerger;
f. any rights or considerations to be granted at the expense of the acquiring entities to parties with special rights vis-à-vis the demerging entity other than as members, such as rights to a distribution of profit, and the date when this grant of rights comes into effect;
g. any benefits granted to a management board or supervisory board member of a party to the demerger in connection with the demerger or to any other party involved in the demerger;
h. the composition of the management boards of the acquiring entities and of the demerging entity which continues to exist, as well as of any supervisory boards after the demerger;

i. the date when the financial data on each of the assets to be transferred are to be recognised in the annual or other financial statements of the acquiring entities;
j. the measures intended by the members of the demerging entity with regard to their acquisition of membership or shares in the acquiring entities;
k. intentions regarding continuation or termination of activities; and
l. the names of the parties called on to approve the demerger resolution.

The following information must also be disclosed in the case of a demerger of a public or private limited company (Article 2:344hh(1) NCC) (this does not apply to parent-subsidiary demergers) (Article 2:334y NCC):

a. the exchange ratio of the shares and the amount(s) of any payments to be made in that regard;
b. the date when and the extent to which the shareholders of the demerging company are to share in the profit of the acquiring entities;
c. the number of shares to be cancelled, if any;
d. the impact of the demerger on holders of non-voting and non-participating shares;
e. the amount of compensation for shares pursuant to Article 2:334ee(1) NCC; and
f. the maximum amount for which compensation can be requested pursuant to Article 2:334ee1 NCC.

In the case of a rancorous demerger, the proposal must also specify which shareholders become shareholders of which acquiring entities (Article 2:334cc(1)(a) NCC).

Disclosure of the information described in last mentioned points a. to f. is not required for a proportional demerger (Article 2:334hh(2) NCC).

Description of assets and liabilities and *pro forma* profit and loss accounts
The demerger proposal should include a precise description of the assets that are to be demerged (see point d. above). This description must be attached to the deed of demerger. Although the level of detail is not prescribed, the description should make it sufficiently clear which assets will belong to which party after the demerger. It is important not only for the entities involved but also the creditors and employees to be able to ascertain from the description who is their new counterparty after the demerger.

The demerger proposal should include the *pro forma* profit and loss accounts or statement of income of both the acquiring entities and the demerging entity which continues to exist (see point d. above), as the demerged components could have significantly different profit generating capacities. According to the legislative history, a general presentation is usually sufficient.

The value of the assets and liabilities at the time of the demerger (see point e. above) which remain with the still existing demerging entity or which are transferred to the acquiring entities, and which are disclosed in the demerger proposal, is crucial given the following and other factors:

- it provides the basis for the court hearing opposition proceedings for ruling whether a creditor has sufficient security for the satisfaction of its claim after the demerger (Article 2:334l NCC);
- it also provides the basis for precisely determining the assets and liabilities belonging to each entity if the description is imprecise in this regard (the so-called 'found objects') (Article 2:334s NCC);
- the value of the assets and liabilities determines the maximum amount for which a party to the demerger can be held liable if a party sues it in the alternative (on the basis of a claim pursuant to Article 2:334t NCC).

Date of recognition of financial data
The demerger proposal must state the date when the assets and liabilities are to be recognised in the financial statements of the acquiring entities (ad i). There are no rules for determining this date; however, there is a need to prevent any failure to recognise assets and liabilities or a particular period of time in financial statements (balance sheet continuity). See also paragraph 32.2.4.

Exchange ratio
A proposal for the demerger of a public or private liability entity must include information about the exchange ratio (see point m. above). The notes to the demerger proposal must explain how the exchange ratio was determined (Article 2:334z NCC; see also paragraph 32.2.6). Among other things, an auditor must state whether, in its opinion, the proposed exchange ratio is reasonable (Article 2:334aa(1) NCC; see also paragraph 32.2.7). If there are listed

shares in the capital of a demerging company, the exchange ratio may depend on their stock exchange listing on one or more dates prior to the date when the demerger becomes effective, to be determined in the demerger proposal (Article 2:334x(1) NCC).

Goodwill and distributable reserves
Unless the parties to the demerger are associations or foundations, the demerger proposal must also disclose the impact of the demerger on the amount of goodwill and distributable reserves of the acquiring entity and of the demerging entity which continues to exist (Article 2:334f(4) NCC). This disclosure may be made in exact amounts, but a general indication of the impact may be sufficient if exact amounts are not yet known when drafting the proposal.

Signature of the demerger proposal
The demerger proposal must be signed by the management board members of each party to the demerger. Unless all parties to the demerger are associations or foundations, the demerger proposal must be approved by the supervisory boards and signed by each of the supervisory board members. If the signature of one or more management board and/or supervisory board members is lacking, this must be disclosed along with the reasons for that (Article 2:334f(3) and (4) NCC). In the case of a parent-subsidiary demerger, approval and signature of the proposal by the supervisory board members is not required (Article 2:334h(1) NCC).

32.2.4 Reporting aspects resulting from a legal demerger

Last financial year of the demerging entity (absolute demerger (zuivere splitsing))
The demerger proposal should disclose the date with effect from which the demerging entity's financial data are to be recognised in the acquiring entity's annual or other financial statements.

If the demerging entity ceases to exist upon the demerger (absolute demerger), it is for practical reasons customary for its financial data to be recognised with effect from the beginning of its last financial year, e.g. 1 January of the financial year in which the demerger will take place. The legal demerger only actually becomes effective as of the date of execution of the deed of demerger (i.e. no retroactive effect); however, the date when the figures of the demerging entity are recognised in the financial statements of the acquiring entities may precede this demerger date. This can save the demerging entity from having to prepare and publish financial statements for the last (often short) financial year before the legal demerger takes effect. The fact is that the last financial year of the demerging entity ends on the date with effect from which its financial data are recognised in the annual or other financial statements of the acquiring entities (Article 2:334q(1) NCC). See also paragraph 32.2.3, point i.

In a separation (afsplitsing), the separating company continues to exist. In that case, there is no last financial year ending in the year of separation. The separating company must therefore prepare financial statements for the whole (financial) year, obviously excluding the financial data relating to the separation from the date that the acquiring entities start to recognise them in their financial statements.

Obligations for the demerging entity to prepare financial statements
The obligations to prepare financial statements incumbent on the demerging entity which ceases to exist upon the demerger, for example in relation to financial years ended before the legal demerger for which no financial statements have yet been prepared or adopted, are automatically the acquiring entities' responsibility following the legal demerger (Article 2:334q(2) NCC). Thus, the bodies of the acquiring entities are then also responsible for the proper satisfaction of these obligations. Exactly which bodies these are is not explicitly regulated by law. It is obvious that the management boards of the acquiring entities will be jointly responsible for any financial statements yet to be prepared. Appointing an auditor and adopting the financial statements would seem to be a responsibility of the general meetings of the acquiring entities, but the management boards of the acquiring entities could also exercise shareholder powers on that company's behalf. It is arguable that if a body of one of the acquiring entities adopts a resolution, the other company/companies is/are then released from this obligation.

Measurement differences between the recognition of assets and liabilities in the last financial statements of the demerging entity and in the initial financial statements of an acquiring entity in which those assets and liabilities are recognised must be disclosed in these initial financial statements (Article 2:334q(3) NCC). The legal reserves created by the demerged entity must be created by the acquiring entities in the same way, unless the legal basis for any such reserves has lapsed (Article 2:334q(4) NCC).

Interim statement of assets and liabilities
The management board must prepare financial statements or an interim statement of assets and liabilities when, at the time the demerger proposal is filed with the Trade Register, more than six months have elapsed since the last financial year for which annual or other financial statements were adopted. This interim statement of assets and liabilities reflects the situation that applies, at the earliest, on the first day of the third month before the month in which the merger proposal is filed with the Trade Register. It should be prepared with due observance of the presentation and measurement methods applied in the most recently adopted annual or other financial statements. If the current value differs significantly from the carrying amount, the current value may be assumed on that basis if justified. The statement of assets and liabilities must also include the amounts to be reserved by law or under the articles of association (Article 2:334g(2) NCC).

Entities that meet the requirements for six monthly financial reporting provided by Section 5:25d of the Financial Supervision Act (*Wet op het financieel toezicht*, Wft) are not required to prepare an interim statement of assets and liabilities (Article 2:334g(3) NCC). An interim statement of assets and liabilities is also not required for proportional demergers (Article 2:334hh(2) NCC).

Example: Interim statement of assets and liabilities in the case of a legal merger

Let us assume that the financial year coincides with the calendar year. If the demerger proposal is filed on 29 March of year 2 and the financial statements for year 1 have been prepared but not yet adopted, those financial statements for year 1 may be used as an interim statement of assets and liabilities. If the demerger proposal is filed after 30 April of year 2 and the financial statements for year 1 have not yet been adopted, those financial statements do not qualify and a separate interim statement of assets and liabilities is required.

If more than six months have elapsed since the last financial year for which financial statements were adopted (e.g. if the demerger proposal is filed on 30 September), then financial statements or an interim statement of assets and liabilities must be drawn up relating to the state of assets and liabilities as at 1 June at the earliest.

32.2.5 Measurement of assets and liabilities by the acquiring entity

The demerger legislation discussed above does not regulate the acquiring entity's measurement of the assets and liabilities it acquires. However, Article 2:334q(3) NCC does provide that any differences between measurement of assets and liabilities in the last financial statements of the demerged entity and in the first financial statements of the acquiring entity must be explained. It may be inferred from this provision that the legislator wanted to keep open the possibility for an acquiring entity to value the assets and liabilities acquired from a demerger differently (i.e. at their fair values). The acquiring entity then in fact apply the purchase accounting method. However, one may also infer from Article 2:334q(3) NCC that the acquiring entity is also free to recognise its acquired assets and liabilities at the carrying amounts previously used by demerging entity. In that case, there is no difference in recognition.

The question is then under what circumstances the acquiring entity may recognise the assets and liabilities at fair value? Alternatively, in what situation is it more appropriate to use carrying amounts previously used by demerging entity?

The answers to these questions depend on the following characteristics of legal demergers:

- reorganisations within a group;
- equal shareholder interests;
- changed shareholder interests.

Reorganisations within a group
Reorganisations based on legal demergers within a group do not affect the composition of the economic unit as a whole. In addition, the interests of the ultimate shareholders do not change.

From the parent entity's point of view, there is no change in control. From the point of view of the acquiring entity, there is an acquisition under common control. In such situations, the obvious course of action is for the acquiring entity to recognise the assets and liabilities at the carrying amounts recorded by the demerging entity in its last financial statements. Indeed, the economic situation in these cases is usually the same or only changes very little, making recognition at fair value difficult to defend. See also paragraph 31.6.

Equal shareholder interests
An absolute demerger may give rise to several separate groups in which the interests of the ultimate shareholders in the demerged activities remain the same, including in relation to each other. For example, an entity demerges its company and its shareholders receive a share in the acquiring entity for each share held in the entity ceasing to exist.

From the point of view of the ultimate shareholders, there is no change in control, as each shareholder still has the same share in the business and assets and liabilities, albeit now divided among several companies. In such situations, the obvious course of action is for the acquiring entities to recognise assets and liabilities at the carrying amounts recorded by the demerging entity in its last financial statements.

However, it is also possible to reason from the perspective of the acquiring entities. Each of them may be viewed as an independent company that is required to prepare financial statements. From the point of view of the acquiring entity, there is an acquisition under common control. From this perspective, it also seems acceptable for the acquiring entity to recognise the assets and liabilities at their fair values. The acquiring entity then in fact apply the purchase accounting method. This is allowed if it does justice to economic reality, i.e. if the economic reality changes sufficiently. See also paragraph 31.6.

Changed shareholder interests
Legal demergers that result in a change in the economic entity and changes in ultimate shareholder interests may occur, for example, in the case of a rancorous demerger or in the demerger of a business unit of a pre-existing entity. The question is how these changes in the shareholder interests should be recognised.

From the perspective that the ultimate shareholder interest changes, it seems obvious that the acquiring entity should recognise the assets and liabilities at their fair values. If these changed shareholder interests mean that other shareholders obtain dominant control over the separated business component, then there is an acquisition by a third party and fair value accounting is required. See Chapter 31. If the same shareholders retain dominant control, the acquisition is one under common control. Recognition may then be at fair value if the economic reality changes sufficiently. See also paragraph 31.6.

However, there are also conceivable situations in which the acquiring entity should simply be viewed as an entity in which some of the activities of the demerging entity are continued. In that case, it would seem more obvious for the acquiring entity to recognise the assets and liabilities at the carrying amounts recorded by the demerging entity in its last financial statements. Indeed, the economic situation in these cases is usually the same or only changes very little, making recognition at fair value difficult to defend. See also paragraph 31.6.

Example: Recognition of a legal demerger using the purchase accounting method

Company XY BV has two activities, namely activity X and activity Y. The company is to be demerged into two new acquiring entities (X BV and Y BV), each of which is assigned one activity. Shareholder A acquires the shares in X BV and shareholder B acquires the shares in Y BV. An auditor certifies that the proposed share exchange ratio is reasonable, as is the proposed division of assets and liabilities. XY BV acquired the activities to be contributed to X BV through a takeover.

The market value of these activities is 100. The fair value of the identifiable assets and liabilities is 80. The carrying amount of these identifiable assets and liabilities at XY BV is 50 upon the demerger (i.e. it excludes the carrying amount of goodwill). The carrying amount at XY BV of the capitalised goodwill relating to the activities to be contributed to X BV is 5. The identifiable assets and liabilities include development costs with a carrying amount of 10. XY BV has created a legal reserve in this regard. X BV acquires the assets and liabilities allocated to it against the issue of shares whose face value is 20.

Applying the purchase accounting method, X BV measures the acquired assets and liabilities at their fair value of 80. The difference with the market value of the contributed activities itself is recognised as goodwill. This is therefore the sum of 20. X BV therefore recognises equity of 100. This consists of issued capital of 20 (its face value), a legal reserve of 10 (the legal reserves created by the demerged entity have to be created by the acquiring entity in the same manner) and share premium of 70 (the remainder).

Example: Recognition of a legal demerger at carrying amounts

The same data as the previous example except that X BV accounts for the demerger at the carrying amounts previously used by XY BV. In this case, X BV measures the acquired assets and liabilities at their carrying amount of 50. X BV does not recognise goodwill as a result of the demerger, but does recognise the carrying amount of the goodwill at XY BV, which was 5. X BV's equity is then 55, made up of issued capital of 20, a legal reserve of 10 and share premium of 25.

32.2.6 Notes to the demerger proposal

In addition to the demerger proposal, the management boards must prepare written notes to it. These notes should disclose the reason for the demerger, the expected impact on the operations and an explanation from a legal, economic and social point of view (Article 2:334g(1) NCC).

In the case of a public or private limited liability entity (but not in the case of a parent-subsidiary demerger, Article 2:334hh(1) NCC, the management board must also disclose the following in the notes to the demerger proposal (Article 2:334z NCC):

a. the method(s) used to determine the share exchange ratio;
b. whether this/these method(s) are appropriate in the particular instance;
c. the measurement resulting from each method applied;
d. if more than one method has been used, whether the relative importance attributed to the measurement methods used may be considered as generally acceptable; and
e. whether there have been any particular difficulties with such measurement and with the determination of the exchange ratio.

A rancorous demerger must also disclose the criteria used in the allocation (Article 2:334cc(1)(b) NCC).

These notes, required by Article 2:334g(1) and Article 334z NCC, are not required in the case of a proportional demerger (Article 2:334hh(2) NCC).

32.2.7 Auditor's report

In a demerger of a public or private limited liability entity, an auditor appointed by the management board should:

- examine and state whether, in its opinion, the proposed share exchange ratio, including with consideration to the attached documents, is reasonable (Article 2:334aa(1) NCC). If the auditor considers that it is not reasonable, this generally results in consultations on whether or not to adjust the exchange ratio. It should be noted that a negative opinion does not prevent the demerger from being effected. In that case, it is up to the shareholders whether they still wish to effect the merger based on the proposed exchange ratio irrespective of the auditor's adverse opinion;
- if separate shareholders of the demerging company become shareholders of separate acquiring entities (rancorous demerger), the auditor must also state, including with consideration to the attached documents, is reasonable (Article 2:334cc(1)(c) NCC). This auditor's report is not required if the shareholders of each party to the demerger agree (Article 2:334cc(2) NCC). If the auditor is of the opinion that the allocation is not reasonable, it may not issue the auditor's report and the demerger proposal will have to be amended;
- if the demerging public limited liability company continues to exist after the demerger, the auditor must also state that the value of the portion of the capital to be retained by the demerging company plus the value of the shares in the capital of the acquiring entities that it acquires upon the demerger, determined as at the date to which its financial statements or interim statement of assets and liabilities relates and, applying generally accepted measurement methods, at least equals the paid-up and called-up part of the capital plus the reserves that the company is required to maintain by law or under the articles of association immediately after the demerger, plus the total amount of the compensation to which shareholders may be entitled pursuant to Article 2:334ee1 NCC (Article 2:334aa(2) NCC). The purpose of the auditor's report is to ensure that the equity of the demerging company does not fall below the amount of blocked assets pursuant to the law and the articles of association. If the auditor is unable to issue this auditor’s report, the merger proposal will have to be amended;

- in addition, the auditor will have to prepare a report setting out its opinion on the management board's disclosures pursuant to Article 2:334z NCC, as described in the second paragraph of paragraph 32.2.6 (Article 2:334aa(3) NCC); and
- examine and state that the value of the portion of the demerging entity's assets acquired by a public limited liability entity upon the demerger at least equals the price of the shares granted by the acquiring public limited liability entity. This description must relate to the amount contributed at a date no earlier five months prior to the demerger. This reason why this auditor’s report is required is that the rules on payment (contribution) on shares in kind (not in cash) apply *mutatis mutandis* (Article 2:334bb(1) NCC).

Exemptions
The auditor's report regarding the exchange ratio and the report on the method used to determine the exchange ratio are not required if the shareholders of each party to the demerger agree (Article 2:334aa(7) NCC). However, the statement of assets and liabilities is then still mandatory.

In the case of a proportional demerger, Articles 2:334aa and 2:334bb NCC do not apply and therefore the auditor's report and the report on the method used to determine the exchange ratio referred to in those articles are not required (Article 2:334hh(2) NCC).

In the case of a parent-subsidiary demerger, the appointment of an auditor pursuant to Article 2:334aa NCC is not required (Article 2:334hh(1) NCC), as in that case all acquiring entities are incorporated upon the demerger and the demerging entity becomes a shareholder in them at the time of the demerger. In the case of a public limited liability entity, however, the auditor’s report regarding the contribution on shares (inbrengverklaring)is required pursuant to Article 2:334bb NCC.

More than one auditor
If an auditor's report and the report on the exchange ratio are required, the management board of each company involved in the demerger must appoint an auditor. If two or more public limited liability entities are involved in the demerger, the principle is that each management board appoints its own auditor, each of the auditors being independent of each other. The purpose of this provision is to safeguard the interests of minority shareholders by having the reasonableness of the exchange ratio assessed by different auditors working independently of each other. The approval of the Enterprise Chamber is required for the appointment of a single auditor (Article 2:334aa(4) NCC).

If more than one auditor is appointed, the auditor’s report regarding the sum of each demerging company's equity only needs to be issued by the auditor acting on each company's behalf.

32.2.8 Publication of demerger documents

Trade register
Each party to the demerger must file at the office of the Trade Register (Article 2:334h(1) NCC):

- the demerger proposal;
- the last three adopted annual or other financial statements of the parties to the demerger, with (if they have been audited) the auditors' report in that regard insofar as those statements are required to be available for inspection;
- the management board reports of the parties to the demerger for the last three completed years insofar as they are or are required to be available for inspection;
- interim statements of assets and liabilities or financial statements that have not been adopted insofar as they are required pursuant to Article 2:334g(2) NCC and insofar as the financial statements of the entity in question are required to be available for inspection; and
- the auditor's report as to the reasonableness of the exchange ratio and the statement of assets and liabilities (Article 2:334aa(6) NCC for public and private limited liability entities), insofar as required, and the auditor’s report regarding the contribution on shares (Article 2:334bb(2) NCC for public limited liability entities).

The annual accounts and the interim statement of assets and liabilities, insofar as they are required to be available for inspection, must be made published in addition to the demerger proposal. This is because the financial data are important to enable creditors to form a sound opinion of the demerger and its impact on the recoverability of their claims.

Availability for inspection at the entity's office
After filing these documents with Trade Register, the management board must immediately make them available for inspection at its own entity's office, together with their notes to the demerger proposal. Annual or other financial statements and management board reports that are not required to be publicly available for inspection (e.g. in the case of associations) as well as any written opinion or comments submitted by the works council, participation council or association of employees. must also be made available for inspection at the entity in question. If the entity does not have its own office, these documents must be made available to a management board member for inspection. They may also be made accessible by electronic means. It should be noted that these obligations do not apply to foundations (Article 2:334h NCC). Public and private limited liability entities must also make the auditor's report available for inspection (Article 2:334aa(6) NCC).

These documents must be available for inspection or accessible by electronic means for six months after the demerger. The persons entitled to inspect them are (Articles 2:334h(2) and 2:334dd NCC):

- shareholders or members;
- holders of a special right vis-à-vis the entity in question, such as a right to a distribution of profit or to subscribe for shares;
- holders of depositary receipts for its shares issued with the cooperation of a public limited liability entity; and
- any holder of meeting rights in a private limited liability entity pursuant to Article 2:227(2) NCC. Besides shareholders, these are holders of depositary receipts who have meeting rights under the articles of association, shareholders who do not have voting rights due to a usufruct or pledge, and usufructuaries and pledgees who do have voting rights.

Persons entitled to inspect these documents may obtain copies of them free of charge for as long as they are available for inspection or accessible by electronic means. Electronic copies may be provided with the consent of a member or shareholder. The entity is not required to provide copies if members or shareholders are able to store them electronically.

Announcement in a daily newspaper
After the documents specified by law have been filed with the Trade Register and are available for inspection at the office of the entity, the parties to the demerger must announce in a national daily newspaper that they are available for inspection, stating the address (Article 2:334h(3) NCC). If the demerger proposal is amended, the documents referred to above must be filed again and a new announcement that they are available for inspection must be published (Article 2:334h(5) NCC).

Changes in assets and liabilities
The management board of each party involved in the demerger is obliged to inform the general meeting and the other parties to the demerger of any material changes in assets and liabilities appearing after the demerger proposal and which affect the disclosures made in the demerger proposal or the notes to them (Article 2:334i(1) NCC). This is not required in the case of a proportional demerger (Article 2:334hh(2) NCC).

32.2.9 Completion of a legal demerger

Guarantee to creditors
In order to prevent opposition by creditors from being declared valid, at least one of the parties to the demerger must provide security or a guarantee to every creditor of those parties who requires this for the satisfaction of their claim. This is not necessary if the creditor has sufficient guarantees or the assets of the entity that is to be its debtor after the demerger provides no less security that its claim will be satisfied than previously (Article 2:334k NCC). This is to protect creditors. They should not be disadvantaged by the demerger. Any creditor who believes that its recovery options will be disadvantaged by the demerger may demand that at one of the parties to the demerger provide a guarantee or other security for the satisfaction of its claim upon the demerger.

Possible opposition from creditors
The purpose of the obligation to make the documents prescribed by law available for inspection at the Trade Register is to protect the counterparties, including creditors, of the parties to the demerger. Any counterparty of the parties to the demerger (i.e. not only the creditors, as is the case with a legal merger) may - under certain circumstances - file opposition proceedings within one month of the announcement of the filing of the demerger proposal (Article 2:334l NCC). That party must then make a plausible case that the assets of the acquiring entity after the merger will provide

less security for the satisfaction of its claim than previously, and that it has not obtained adequate guarantees. The objection may succeed in the event of non-compliance with the rule that, in principle, a legal relationship may only be transferred in its entirety (Article 2:334j NCC), or if a guarantee demanded by a creditor is required (Article 2:334k NCC). Before issuing its decision, the court may give the parties to the demerger an opportunity to correct the failure in question. If opposition proceedings are timely, the deed of demerger may only be executed once the opposition has been withdrawn or the lifting of the opposition is enforceable (Article 2:334l(3) NCC). If the deed of demerger has nevertheless been executed, the subdivision is voidable for that reason (Article 2:334u(1)(b) NCC). If the opposition is dismissed, the court will lift it.

Demerger resolution
The rules on decision-making and the effectuation of demergers are similar to those for legal mergers. A demerger resolution is adopted by the general meeting. In a foundation, any party authorised to amend the articles of association, or alternatively the management board, adopts this resolution (Article 2:334m(1) NCC); this resolution requires the District Court's approval unless the articles of association provide for the possibility to alter all of its provisions (Article 2:334m(5) NCC).

A resolution to demerge must be adopted in the same way as a resolution to amend the articles of association, unless the articles of association include different provisions regarding demerger resolutions. If the law requires the consent of all or certain shareholders for a resolution to amend the articles of association, the same applies to the demerger resolution (Article 2:334m(3) and (4) NCC).

The demerger resolution may not differ from the demerger proposal (Article 2:334m(1) NCC). If there is any change, the procedure prior to the demerger resolution must be gone through again (Article 2:334h(5) NCC). The demerger resolution may only be adopted one month after the date when all parties to the demerger have announced the filing of the demerger proposal (Article 2:334m(2) NCC). This period serves to allow the counterparties of the parties to the demerger, including creditors, to oppose the demerger proposal.

Unless the articles of association provide otherwise, an acquiring public or private limited liability entity may decide to demerge by a management board resolution. The same applies to the demerging entity if:

- all acquiring entities are public or private limited liability entities incorporated upon the demerger and the demerging company becomes their sole shareholder upon the demerger; or
- the acquiring entities own all the shares in the demerging company.

Such a decision may only be taken if the company has disclosed its intention to do so in the announcement that the demerger proposal has been filed. Shareholders representing at least 20 per cent of the issued capital may stop this decision by requesting the management board to convene a general meeting to decide on the demerger within one month of the announcement (Article 2:334ff NCC).

Effectuation of the demerger
The demerger is effected by notarial deed (Article 2:334n(1) NCC). The demerger is effected with the execution of a notarial deed. This deed creates rights. The deed must be authentic. The parties to the demerger enter into the legal act of demerger by notarial deed. Parties to this deed are the demerging entity as well as any acquiring entity, with the exception of entities created at the time of demerger. The demerger takes effect the day after the deed is executed (at midnight) (Article 2:334n(1) NCC).

The civil-law notary assesses whether the formal requirements by law and under the articles of association have been complied with, and certifies this at the foot of the deed (Article 2:334n(2) NCC).

The day after this deed is executed, the transfer by universal title of some or all of the assets and liabilities of the demerging entity to the acquiring entity is thus an established fact. In the case of an absolute demerger, the demerging entity ceases to exist. In the case of a separation, the demerging entity does not cease to exist. The deed may only be executed within six months of the announcement of the filing of the proposal or, if this is not allowed due to opposition lodged, within one month after it has been withdrawn or its lifting has become enforceable. Therefore, this six-month period may only be extended if opposition proceedings have been filed, but is limited to one month after the opposition has been withdrawn or after its lifting has become enforceable. A description must be attached to the deed making it possible to determine precisely which assets and liabilities of the demerging entity are to be transferred to each of the acquiring entities and, if not all of its assets and liabilities are to be transferred, which assets it will retain, as well as a *pro forma* profit and loss account or statement of income of the acquiring entities and the demerging entity that continues to exist (Article 2:334n(2) in conjunction with Article 2:334f(2)(d) NCC).

Registration of the demerger in the Trade Register and other public registers
Publication of the demerger is made by requiring each acquiring entity as well as the demerged entity to register the demerger in the Trade Register within eight days of its execution. Where the demerged entity has ceased to exist as a result of the demerger, the acquiring entities must arrange for registration of the demerger in the Trade Register in which the demerged entity is listed. For each registration, a copy of the demerger deed, including the civil-law notary's declaration at the foot of it, must be filed with the office of the Trade Register (Article 2:334n(3) NCC). Within one month of the demerger, the acquiring entities must notify the other public registers where the transfer of rights or the demerger are to be recorded. This notification relates to any property transferred to the acquiring entities upon the demerger (Article 2:334n(4) NCC).

32.3 Cross-border operations

Cross-border operations consist of cross-border mergers, demergers and conversions. The provisions relating to these operations have recently been amended and expanded as a result of the implementation of the Act Implementation Directive cross-border conversions, mergers and demergers (Parliamentary paper 36 267), which entered into force on 1 September 2023. This act implements Directive (EU) 2019/2121, also known as the Mobility Directive. The act amends the long-standing procedural regulations for cross-border mergers and provides new procedural regulations for cross-border conversions and demergers. Until 1 September 2023, the Netherlands did not yet have a legal regulation for a cross-border conversion and demerger.

Cross-border mergers
The specific provisions for a cross-border merger are included in Article 2:333b to 2:333l NCC (Section 3A of Title 7 Book 2 NCC). A cross-border merger exists when a Dutch public limited liability entity, private limited liability entity or an European cooperative entity merges with an entity that has share capital or cooperative entity governed by the law of another EU or EEA Member State. For example, a merger of a Dutch public limited liability entity and a Belgian public limited liability entity, where only the Dutch public limited liability entity remains after the merger or a merger of a French SA and a Belgian private limited liability entity that merge into a new Dutch private limited liability entity to be established. Article 2:333c NCC elaborates on the various forms of a cross-border merger.

Cross-border demergers
The specific provisions for cross-border demergers have been in effect since 1 September 2023 and are included in a new Section 6 of Title 7 Book 2 NCC (Article 2:334jj through 2:334yy NCC). This section contains various additions and amendments to the provisions on non-cross-border demergers included in Sections 4 and 5 of Title 7 Book 2 NCC. The provisions apply in the following situations (Article 2:334jj(1) NCC):

- in the case of a demerger of a public limited liability entity or private limited liability entity, one or more limited liability entities that have share capital are established governed by the law of another EU or EEA Member State. For example, a Dutch private limited liability entity that is split into a German GmbH to be established and a French S.A. to be established, whereby the Dutch private limited liability entity ceases to exist (an absolute demerger – 'zuivere splitsing');
- in the case of a demerger of an entity that has share capital governed by the law of another EU or EEA Member State, one or more public limited liability entities or private limited liability entities are established as acquiring entities. For example, a German GmbH that transfers part of its assets and liabilities to a new Dutch private limited liability entity to be established (a separation – 'afsplitsing').

The provisions therefore do not apply in the case of a demerger to existing companies (Article 2:334jj(3) NCC). The EU directive also does not allow such a demerger variant.

Cross-border conversions
In the implementation act, it has been decided to include a new Title 7A Specific Provisions for Cross-Border Conversions in Book 2 NCC (Article 2:335 to 2:335p NCC). A cross-border conversion occurs when a public limited liability entity or private limited liability entity is converted into an entity that has share capital governed by the law of another EU or EEA Member State or if such an entity that has share capital is converted into a public limited liability entity or private limited liability entity (Article 2:335(1) NCC). For example, a Dutch private limited liability entity that is converted into a German GmbH or vice versa.

Overview of specific provisions
The EU directive prescribes the framework conditions that must be met before a cross-border operation can take place and includes procedural regulations. The required procedure consists of three stages:

- preparation;
- decision-making by the general meeting; and
- execution.

As cross-border operations (may) entail changes for shareholders, creditors and employees, the EU directive also includes a harmonised regime for the protection of these stakeholders. For example, the rights of shareholders may change because they become shareholders in an entity governed by the law of another Member State. Creditors of an entity may be disadvantaged because their debtor's country of residence changes. The position of employees may change insofar as they influence the appointment or dismissal of management or supervisory board members through the work council established by the entity. The protective measures include:

- shareholders who have voted against the decision on a cross-border operation, shall have the right to exit and the right to challenge the exit indemnity and the exchange ratio following the decision on the cross-border operation before a body authorised under national law if they do not consider those aspects reasonable;
- creditors will have the possibility to apply to an (administrative or judicial) authority within three months after publication of the operation proposal for the enforcement of safeguards (such as a (bank) guarantee or a pledge) if they are not satisfied with the safeguards offered in this proposal;
- in the case of a cross-border merger, the entity will have to negotiate with the employees more often than is currently the case after the publication of the proposal in order to reach an agreement on employee participation in the entity after the cross-border merger. In short, this participation concerns the right to influence the composition of the management or supervisory body. A similar regime applies to the cross-border demerger and conversion.

The various phases and the safeguards for shareholders, creditors and employees in the event of a cross-border merger, demerger and conversion respectively are incorporated in Book 2 NCC as follows (overview derived from the Explanatory Memorandum to the implementation act):

	Merger	Demerger	Conversion
Preparation phase			
Proposal for merger, demerger or conversion	2:333d	2:334ll	2:335b
Notification to shareholders, creditors and work council	2:333e(1)	2:334mm(1)	2:335c
Written disclosure	2:333f	2:334nn	2:335d
Audit	2:333g	2:334oo	2:335e
Inspection and publication	2:333e(2 and 3)	2:334mm(2 and 3)	2:335(f and g)
Decision-making phase	2:333gb	2:334pp	2:335h
Execution phase			
Pre-operations certificate (notary declaration)	2:333i	2:334uu	2:335l
Final certificate (notary declaration)	2:333ia	2:334vv	2:335m
Registrations and deregistrations in the Trade Register	2:333j	2:334ww	2:335n
Safeguards			
Shareholders	2:333h	2:334qq	2:335i
Creditors	2:333ha	2:334rr	2:335(j and k)
Employees (participation)	2:333k	2:334xx	2:335o

32.4 Exemptions for small and medium-sized entities

There are no exemptions for small and medium-sized entities.

32.5 Significant differences from IFRS

There are significant differences in the recognition of mergers and acquisitions compared to IFRS 3 Business Combinations. See Chapter 31 in this regard.

33 Consolidation

33.1 Introduction and definitions

The consolidated financial statements
Consolidated financial statements are the financial statements in which the assets, liabilities, income and expenses of the entities and companies forming a group or part of a group and other entities and companies incorporated into the consolidation are included as a whole (Article 2:405(1) NCC). In accordance with Article 2:362(1) NCC, the consolidated financial statements must provide an insight into the equity and profit or loss of all the entities and companies included in the consolidation (Article 2:405(2) NCC). The consolidated financial statements are a separate part of the financial statements (in addition to the company-only financial statements) and do not count as notes to the company-only financial statements (as they did in the past). Company-only financial statements are the financial statements of the entity itself.

The terms 'group' and 'group entities'
According to Article 2:24(b) NCC, a group is an economic unit in which entities and companies are organisationally connected. This definition gives two criteria that must be met for there to be a group relationship, namely economic unity and organisational affiliation. DAS 217.201 states that it can be inferred from the legislative history that the element of central management is also essential.

There is a link between these three criteria. After all, an economic unity presupposes organisational affiliation and/or central management. Typically, a group is a set of entities and companies (hereafter collectively referred to as companies) that are under central management, such that they form an economic unit.

The term group relationship was changed following an amendment in the law, which was implemented in 2005 following the introduction of IAS/IFRS in the European Union. This is discussed in the following paragraphs.

Consolidation scope: ability to exercise control
Until the amendment of Title 9 Book 2 NCC 2005 (Amendment Act Implementing IAS Regulation, IAS 39 Standard and Modernisation Directive; Parliamentary Paper 29737; henceforth 'IAS Regulation Act') (see also paragraph 1.1.1), the group concept was central to judging which entities should be included in the consolidation, i.e. in determining the consolidation scope. With this legislative amendment, the consolidation scope in Title 9 Book 2 NCC was brought into line with the consolidation scope that applied in IAS 27 at the time, consisting of entities and companies ('subsidiaries') controlled by the parent. The legislative amendment added the following italicised section (inserted by us) to Article 2:405(1) NCC:

Consolidated financial statements are those in which the assets, liabilities, income and expenses of the entities and companies forming a group or part of a group *and other entities and companies incorporated into the consolidation* are included as a whole (Article 2:405(1) NCC).

We also see this scope reflected in Article 2:406(1) and (2) NCC (see under the next heading), which has also been amended by the IAS Regulation Act. For example, since this legislative amendment, it is no longer possible to exclude entities and companies from consolidation due to differences in business activities.

Group relationship and power to determine policy
Article 2:406(1) and (2) NCC provides that the entity that heads its group or part of a group, alone or together with another group entity, shall prepare consolidated financial statements containing its own financial information with those of its subsidiaries in the group, other group entities and *other entities that it can control or over which it has central management*. The italicised section has again been added following the IAS Regulation Act. The legislative history shows that, with this amendment, the legislator wishes to reflect the broadening of the consolidation scope provided by the Seventh EEC Directive (now succeeded by the EU Accounting Directive) and, in doing so, also wishes to tie in with the group concept according to IAS/IFRS (Parliamentary Paper 29737-3 page 27).

The Dutch Accounting Standards Board states that a group relationship exists if, based on the de facto situation, one company essentially controls another. Or has power to determine policy in that other (controlled) company (DAS 217.202). This should in all cases be determined on the basis of the totality of factual circumstances and contractual relationships (DAS 217.203).

Group relationship determines the consolidation scope
We consider the criteria 'being able to exercise control', 'essentially controlling the other company' and 'having power to determine policy' to be interchangeable when it comes to determining the consolidation scope. Specifically, in our view, this means that the Dutch Accounting Standards Board has in principle linked the term 'group relationship' to this core criterion of being able to exercise control. Thus, by this interpretation of the group concept, the Dutch Accounting Standards Board follows the legal criterion for whether or not entities and companies are included in the consolidated financial statements. In other words: in principle, a group relationship exists if an entity can exercise control over another company. The exception is the so-called 'personal holding entity', according to the Dutch Accounting Standards Board. For the latter: see paragraph 33.2.2.

Example: A parent entity with different business activities

The shares of M BV, a private limited liability entity, are 100% owned by shareholder P. M's core business is the sustainable generation of energy from wind, biomass and hydropower. P also holds all the shares of a separate company (H BV) dedicated to energy trading by market arbitrage. P sees this as a somewhat out-of-control hobby born of progressive understanding of how energy markets work. Due to tax reasons, P decides to spin off the generation business into a separate subsidiary E BV. Also, M acquires the shares in trading entity H from P in exchange for shares in M. So M BV now has two subsidiaries: E BV and H BV. P believes that the group as such consists of M and E because M's object according to its articles of association is focused on renewable energy generation. According to P, there is no group relationship between M and H. Thus, according to P, this entity does not belong to the consolidation scope and therefore does not need to be consolidated.

This reasoning could still have held true until the law was amended in 2005 on the basis of reliance on non-business activities. However, after the legislative amendment, E and H will have to be included in M's consolidated financial statements. After all, M is the head of a group and can exercise control over both entities. The difference in operating activities can be further explained in the notes to the financial statements. For example, by including segmented information (see paragraph 30.6).

Example: A highly diversified participation entity

Participation entity P BV, a private limited liability entity, has several wholly-owned subsidiaries that are highly decentralised. The management boards of the subsidiaries are relatively independent in carrying out financial and operational policies. However, P does keep its finger on the pulse by providing a supervisory board member and setting targets on critical performance measures. As a 100% shareholder, P has the power to replace the members of the Supervisory Board and Management Board (or have them replaced). P believes that due to the subsidiaries' great independence and lack of central management, there is no group relationship between P and the subsidiaries.

It is clear that P can exercise control over the subsidiaries which in principle creates a group relationship between P and the subsidiaries. P could, however, qualify for a limitation of the consolidation scope if and to the extent the interests in the subsidiaries are held only with a view to their disposal (Article 2:407(1)(c) NCC). However, a concrete exit strategy should be formulated. See also paragraph 4.3 of this chapter. Therefore, if this condition is met for all subsidiaries, P has no equity interests to be included in the consolidation and a de facto consolidation exemption arises because the consolidation scope is empty.

Power to determine policy is usually exercised on the basis of the ability to exercise a majority of voting rights in the shareholders' meeting. Thus, a group relationship usually exists between a parent entity and a subsidiary. However, this is not always the case. For example, by virtue of articles of association, a contract or other arrangement or by virtue of appointment rights, the influence of the majority shareholder may be infringed to such an extent that the decisive influence thus lies not with this shareholder but with third parties. In that case, the subsidiary is not a group entity of the parent.

Thus, in addition to voting rights, other rights must be taken into account when assessing whether decisive influence exists. For example, rights arising from a shareholders' agreement or a loan contract. Resulting rights may be protective rights (DAS 217.202a). Protective rights do not give a party power to determine policy, because they are only designed to protect the interest of the rights holder. This could include the right, in the case of a minority interest in a participating interest, to consent to decisions on, for example, major capital expenditures not required in the normal course of business, issue of equity instruments or directors' remuneration.

In determining whether a group relationship exists, any potential voting rights should be considered, such as share options, convertible instruments or equity instruments (DAS 217.203). If those potential voting rights can be exercised in such a way as to give the entity more or less influence in another company, they should also be taken into account. All the facts and circumstances are taken into account when assessing whether financial instruments carrying potential voting rights confer greater or lesser influence.

These facts and circumstances include, but are not limited to, the following (DAS 217.203):

- (economic or other) impediments preventing the holder(s) of the potential voting rights from exercising them;
- the ability of the rights owner(s) to benefit from exercising their rights.

Example: Potential voting rights (extracted from DAS 217.203)

A BV, a private limited liability entity, owns 60% of B BV's ordinary share capital (and the voting rights attached to it). A then sells 20% of it to C BV, which did not have any shares in B. A also acquires a call option from C to repurchase these (20%) shares in B. This call option is immediately exercisable at a price slightly higher than the market price of those shares when the option was issued. The strike price of the option is not set so high that it is highly unlikely that the option will be exercised. Because A acquired the call option, it can still exercise power to determine policy in B. The fact is that A can exercise the option at any time and thus again exercise 60% of the voting rights in B.

Example: Potential voting rights and financial opportunity

Company A BV and B BV, both private limited liability entities, have respectively 55% and 45% of the ordinary shares, which have a voting right in the shareholders' meeting of company C BV. B also has a call option with A as counterparty, giving it the right to acquire 15% of C's ordinary shares at a fixed price. This call option is immediately exercisable at a price somewhat higher than the market price of those shares when the option was issued. The call option can be exercised at any time. The total acquisition price upon exercise of the option is a significant amount compared to B's equity. B's profits have fallen sharply in recent years and are not expected to improve in the coming period. B has an ongoing agreement with the banks that existing debt will be reduced gradually and without coercion in order to strengthen balance sheet solvency. B has no further access to the capital market. This puts B in the position of being unable to obtain additional financing.

B's financial inability to finance the strike price leads to the conclusion that there are economic and other barriers preventing B from exercising the option. For this reason, the conclusion that B does not have the power to determine policy in C is justified.

Evidence of a group relationship
The actual determination of whether there is power to determine policy XE " and therefore a group relationship is not straightforward in certain situations. The following circumstances may provide significant evidence of the existence of a group relationship (DAS 217.204):

- all activities of a company are in fact carried out for the benefit of the (participating) entity in accordance with its specific desire. As a result, the entity obtains economic benefits related to the activities of that company. Moreover, economic dependence in itself (such as that of a supplier or a key customer) is not sufficient to conclude that there is power to determine policy;
- the entity in fact has control over another company such that it controls or is able to control that company or its activities. Such control may have been delegated to others such that the entity in fact still controls or can control that company or its activities. For example, the entity may have the power to terminate the activities of that company or dissolve that company, it may have the power to amend the articles of association of that company, or it may veto proposed amendments to the articles of association;
- the entity in fact has the right to obtain the majority of the economic benefits from the activities of the controlled company, for example, under a law, contract or other arrangement. This right may indicate the presence of

decisive influence if the entity enters into transactions with that company and the financial profit or loss accrue to the entity under the arrangement; and

- the entity in fact bears more than half the economic risk in respect of that company or its assets.

These indications are a further elaboration of what is regulated in DAS 217.202 and cannot be overruled by the ultimate finding that there is no power to determine policy. If there is significant compliance with the indications contained in DAS 217.204, there is power to determine policy and, according to the Dutch Accounting Standards Board, there is a group relationship. There can also be a group relationship between sister companies under certain circumstances, namely in the case where one sister company has, in fact, control over the other sister company. These assessments should also follow the aforementioned guidance in DAS 217.201 to 204.

Example: Group relationship between sister companies

A natural person A owns all the shares in holding entity H. In addition, A also owns 100% of the shares in an operating company (W3). H holds all the shares of the operating companies W1 and W2. The mere fact that H and W3 have the same shareholder (natural person A) does not imply that a group relationship exists between these companies. A group relationship exists if H has control in W3 or vice versa. Therefore, if the natural person A itself determines policy in H and W3 and therefore no sister company (H or W3) can be identified that determines policy in the other sister company (H or W3), consequently neither H nor W3 is 'horizontally' consolidated (see DAS 217.211).

Special purpose entities
A specific group of companies involves special purpose entities (SPE). SPEs are usually set up to fulfil a special purpose and can take the form of an entity (private limited company, foundation, etc.) or of an unincorporated company (CV, VOF, trust, etc.) SPEs are companies in which only narrowly defined activities take place, for example collection of trade receivables or property management, usually for the exclusive benefit of the entity. Since the amendment to Article 2:406 NCC in 2005 and the defining of a group relationship in DAS 217, it is no longer relevant for answering the question of whether an SPE is part of the consolidation scope, whether an SPE qualifies as a group entity. If control can be exercised over the SPE, there is a group relationship and the SPE is consolidated. The above indications of a group relationship are also helpful in assessing whether a SPE is part of the consolidation scope. If the activities of a SPE are carried out according to the specific desire of an entity and the company is established for no purpose other than to execute this desire, it will generally be the case that the SPE is part of the consolidation scope.

Other entities over which control or central management may be exercised
These entities are companies that, in a strictly formal sense are not group companies according to Article 2:24b NCC but over which control or central management can be exercised, as a result of which there is indeed a *group relationship*. As indicated earlier in this section, this expansion of the consolidation scope took place when the law was amended in 2005 (IAS Regulation Act). This was done with the aim of including all entities over which control can be exercised, in the consolidation scope.

Closing thoughts on the group concept
In our opinion, it would have been better if the legislator, when amending the law in 2005, had also amended the terms in Article 2:24 NCC (group, group company, subsidiary) and brought them in line with the definitions in IAS 27 'Consolidated and Separate Financial Statements' (now IFRS 10 'Consolidated Financial Statements') applicable at the time with respect to provisions on the obligation to consolidate. This standard only uses the terms *parent* and *subsidiary* (criterion: ability to exercise control) as concepts. The consolidation scope then consists of the *parent* and its *subsidiaries*. It is important to realise that entities over which control can be exercised must also be included in the consolidation scope according to Dutch Law and according to the interpretation in the Dutch Accounting Standards. The argument that there is no group company due to the absence of an economic unit, organisational affiliation or central management (while control can be exercised) therefore no longer holds, and is actually based on an outdated interpretation of the group concept. With the amendment, the consolidation scope has been brought inline with the IAS/IFRS framework (refer to the beginning of this paragraph), resulting in no significant difference between NL GAAP and IFRS concerning the concept of the consolidation scope.

33.2 Consolidation obligation

The consolidation obligation is prescribed by Article 2:406 NCC. A distinction is made between the consolidation obligation at the head of the group and the consolidation obligation at the intermediate holding entity.

33.2.1 Consolidation obligation of head of group

An entity that heads its group, alone or together with another group entity, prepares consolidated financial statements, which include its own financial information with those of its subsidiaries in the group, other group entities and other entities which it can control or over which it has central management (Article 2:406(1) NCC). See paragraph 33.1 for the concepts of group, group relationship, and control.

33.2.2 Consolidation obligation of personal holding entity

A personal holding entity means an entity whose shares are wholly and directly owned by a natural person (and possibly other natural persons who are in close or family relationship with this natural person) and which safeguards and structures the private interests of this natural person (DAS 217.0). A personal holding entity meeting this definition may hold an interest in one or more underlying companies. Such a personal holding entity that owns the majority of shares in another company often has, by virtue of this shareholding, the majority of voting rights in the general meeting of this company and the majority of the economic benefits of this company. However, this does not necessarily mean that the personal holding entity then heads the group (DAS 217.209).

Example: Personal holdings (extracted from DAS 217.209)

A BV as personal holding entity holds all the shares in Holding B BV, a company which holds all the shares in operating companies C BV, D BV and E BV. It must be assessed whether A is at the head of the group. This is the case if there is a group relationship between A and B, where A is the head of the group, with power to determine policy, and B is the controlled entity. If there is no group relationship between A and B, B will normally be the head of the group and C, D and E will be group entities of B.

For determining whether a personal holding entity is the head of a group and therefore subject to consolidation, the Dutch Accounting Standards Board has adopted a principles-based approach. It has to be determined whether there is a group relationship between the personal holding entity and the underlying company/companies and that, therefore, the personal holding entity is the head of the group. A personal holding entity that holds interests in more than one underlying company is generally more likely to (have to) qualify as the head of a group than a personal holding entity that holds an interest in only one company. This should be assessed according to the specific facts and circumstances (DAS 217.209).

For determining whether a personal holding entity is the head of a group and therefore subject to consolidation obligations, the Dutch Accounting Standards Board had included a number of indicators in a draft standard in the 2006 annual edition of the Dutch Accounting Standards. Given the nature of the comments received on this draft standard, the Dutch Accounting Standards Board decided not to include the mentioned indicators in a final standard. Despite this decision, we believe that these indicators can play a supporting role in answering the question of whether a group relationship exists. Failure to meet any of the listed indicators is an indication that a personal holding entity is the head of a group. However, all of the facts and circumstances should be considered when determining whether a group relationship exists. Possible indicators of the lack of a group relationship are:

- the personal holding entity has the nature of a holding company and does not carry out any activities other than holding an equity interest in one underlying company, holding the director-major shareholder's pension entitlements or other old-age provisions under its own management and investing the funds for their fulfilment, and otherwise holding investments (including real estate investments, including those leased to related parties). Thus, the personal holding entity also does not exercise management over one or more other entities or companies. This condition is inherent in meeting the definition of a personal holding entity;
- the personal holding entity has no debt to credit institutions or other similar debt to third parties or related parties, except for any debt to the director-major shareholder. In this context, debt to credit institutions does not include a relatively small negative bank balance on the reporting date, where the entity is not structurally financed by that credit institution. Financing debt also excludes debt to creditors and tax authorities customary on the reporting date or debt of a corresponding nature; and
- the personal holding entity has not guaranteed or held itself jointly liable by a legal act for the benefit of one or more underlying companies or entities, with the exception of guarantees under fiscal unities.

In accordance with Article 2:379 NCC, the personal holding entity discloses in the notes the name, domicile and share provided in the issued capital of the underlying company. It also discloses the amount of equity and profit or loss according to the latest adopted financial statements of the underlying company, unless one (or more) of the conditions of Article 2:379(2) NCC are met.

Closing thoughts on the concept of the personal holding

The concept of a personal holding is not included within IFRS. This is logical to the extent that a personal holding *can* exercise control on the basis of its voting rights over the underlying subsidiary holding entity that, in a de facto sense, controls the group. From a pure perspective, it would therefore be more appropriate to speak of a consolidation *exemption* in the situation of a personal holding. In the example above, taken from DAS 217.209, de facto management will only be exercised by Holding B because, in accordance with the definition of a personal holding, A is simply established to structure the equity interests of the sole shareholder. Requiring at the level of the personal holding to prepare consolidated financial statements adds nothing to the judgment of the stakeholders involved in Holding B. The Dutch Accounting Standards Board therefore allows a personal holding to be seen as a de facto extension of the *natural person* (the 100% shareholder) and therefore is not considered to be the head of the group. Just as a natural person is not required to consolidate, the same applies to their extension in the form of a personal holding.

33.2.3 Consolidation obligation of intermediate holding entity

The consolidation obligation of the intermediate holding entity is regulated by Article 2:406(2) NCC. Pursuant to this article, the entity to which paragraph 1 (consolidation obligation for head of group) does not apply, but which has in its group one or more subsidiaries or other entities over which it can exercise control or over which it has central management, has to prepare consolidated financial statements. This provision means that an intermediate holding entity with at least one subsidiary in its part of the group has a consolidation obligation. This also applies in the case where the intermediate holding entity does not exercise power to determine policy in its part of the group. An intermediate holding entity with at least one other entity in its part of the group over which a control can be exercised or which is under central management also has a consolidation obligation. The law provides for a consolidation exemption for such intermediate holding entities if certain conditions are met (Article 2:408 NCC). This exemption from the consolidation obligation is discussed in more detail in paragraph 33.3.2.

33.3 Exemption from consolidation obligation

Exemption from consolidation obligation can be obtained in two cases, namely on the basis of the size of the entity and on the basis of the exemption for intermediate holding entities.

33.3.1 Exemption for small groups (Article 2:407(2) NCC)

Under Article 2:407(2) NCC consolidation is not required in the case of 'small groups' if:

- on a consolidated basis, the group would not exceed the limits for a small entity set out in Article 2:396 NCC;
- no company to be included in the consolidation is an entity that is a public interest entity (see paragraph 1.1.1); and
- no objection to the entity has been lodged in writing within six months of the start of the financial year by at least one-tenth of the members or by holders of at least one-tenth of the issued capital.

Under this consolidation exemption, the 'two-year' criterion for determining the size of a company applies, since the rules on regime change are included under the limits of Article 2:396 NCC. This effectively means that the first-mentioned condition in Article 2:407(2) NCC is met if an entity qualifies as a small entity (DAS 217.217). This means that a group that meets the size criteria of a small entity in year 1 and 2 on a consolidated basis, but no longer meets it in year 3, may still apply the consolidation exemption of Article 2:407(2) NCC in year 3.

Example: Small group consolidation exemption and application of 'two-year' criterion

Holding Group A BV has a balance sheet total of 8,000,000 in year 1 and year 2 on a consolidated basis, net revenue of 11,000,000 and an average of 40 employees. Thus, in both year 1 and year 2, the limits for a small entity set out in Article 2:396 NCC are not exceeded. From year 3, net revenue rises to 16,000,000. In year 3, therefore, the thresholds for a small entity are exceeded. Under the 'two-year' criterion, Holding Group A BV may still apply the consolidation exemption of Article 2:407(2) NCC in year 3. From year 4, Holding Group A BV can no longer make use of that exemption.

However, the 'two-year' criterion does not apply to the first year after application of the consolidation exemption for intermediate holding entities of Article 2:408 NCC (see paragraph 33.3.2).

Example: Small group consolidation exemption after application of Article 2:408 NCC

Holding Group B BV has a balance sheet total of 20,000,000 in year 1 and year 2 on a consolidated basis, net revenue of 100,000,000 and an average of 150 employees. This exceeds the limits for a small entity set out in Article 2:396 NCC in both year 1 and year 2. For year 1, Holding Group B BV does not prepare consolidated financial statements under the exemption of Article 2:408 NCC. As Holding Group B BV does not exceed the limits of Article 2:396 NCC on a standalone basis, it is classified as a small entity (Article 2:396(2) NCC).

In year 2, Holding Group B BV no longer makes use of the exemption of Article 2:408 NCC. As both year 1 and year 2 exceed the limits for a small entity specified in Article 2:396 NCC, Holding Group B BV cannot apply the consolidation exemption for small groups (Article 2:407(2) NCC). As a result, Holding Group B BV has to prepare consolidated financial statements for year 2.

It is common for small entities to include consolidated financial statements in their financial statements prepared for adoption. In that case, these consolidated financial statements need not be included in the annual accounts to be filed.

Example: Publication of consolidated financial statements by small entities

The presentation documents of a small entity include consolidated financial statements. The group qualifies as small. Does this therefore mean that consolidated financial statements should be published? Should it therefore be explained in more detail, or will just the consolidated balance sheet suffice?

As this is a small entity, consolidated financial statements need not be prepared. If this is done on a voluntary basis in the financial statements prepared for adoption, these consolidated financial statements need not be included in the annual accounts to be filed.

Where consolidated financial statements or a consolidated balance sheet are nevertheless published, the rules as set out in Part 13 of Title 9 of Book 2 NCC apply. Pursuant to Article 2:410 (1) NCC, the provisions of Title 9 of Book 2 NCC for the financial statements and parts thereof apply mutatis mutandis to the consolidated financial statements. This means that as with the company-only financial statements, notes are required. However, some exceptions do apply to the level of detail of the items (see, for example, those mentioned in Article 2:410 NCC). These rules remain in force if use is made of the consolidation exemption for small groups (Article 2:407(2) NCC).

Application of the consolidation exemption for small groups cannot result in only part of the group entities being consolidated.

Example: Applying consolidation exemption for small groups

There is an entity with two equity interests that qualify as group entities. The group is small. The entity that is the head of the group intends to consolidate one group entity for reasons of comparability of figures after the collapse of activities. The other participating interest is not consolidated. Here, they rely on the consolidation exemption ('it is a small group after all'). Is this course of action permissible?

No. The other group entity should also be consolidated. Its omission based on the 'small group' criterion is not justified, as use is not being made of this exemption. Article 2:407(2) NCC allows a small group to choose to not consolidate, if a number of conditions are met. This is an exemption the company can make use of. Where it does not do so, the normal rules of consolidation apply. This means that both group entities have to be consolidated.

Concurrence with the group exemption (Article 2:403 NCC)
A so-called 403 statement may have been issued by the head of the group or an intermediate holding entity of a small group for the benefit of one or more group entities. In addition, if other conditions are also met, that group entity does not have to prepare and publish financial statements in accordance with Title 9 Book 2 NCC. This exemption is discussed in detail in paragraph 1.7. Another condition is that the financial data of that group entity are included in the consolidated financial statements of the entity that issued the 403 statement. This means that that entity cannot then use the consolidation exemption for small groups of Article 2:407(2) NCC.

33.3.2 Exemption for intermediate holding entities (Article 2:408 NCC)

The exemption under Article 2:408 NCC means that an intermediate holding entity does not have to prepare consolidated financial statements if the financial information that the intermediate holding entity would be required to consolidate are included in the consolidated financial statements of a larger entity. The rationale behind this exemption is that understanding the whole group in principle makes it unnecessary to also provide a picture of a part of a group.

Equivalent to the EU Accounting Directive/IFRS-EU?
A condition for making use of this exemption is that the consolidated financial statements of the larger entity (which include the data of the intermediate holding entity) and the management board report have been prepared in accordance with the requirements of the EU Accounting Directive (Directive 2013/34/EU) or in an equivalent manner. The IASB's standards ('full IFRS') can be considered equivalent. IFRS-EU can also be considered equivalent.

Based on a decision previously taken by the European Commission (2008/961/EC) and subsequent implementing decisions, there seems to be no objections to considering the financial reporting standards applied by listed entities in the United States (US GAAP), Japan, China, and South Korea as equivalent to the EU Annual Accounts directive or IFRS-EU respectively. The status of India-GAAP from our perspective is not entirely clear because, in the (to our knowledge) last implementing decision of the European Commission (2015/1612/EU), there was a condition regarding the adaptation of India-GAAP – to be applied by listed entities – to IFRS.

These previously mentioned implementing decisions have been taken in the context of listing, or applications for listing, in Europe of companies originating from one of the aforementioned countries where the European Commission has been advised on the quality of the reporting standards by the umbrella authority of European stock exchange regulators (ESMA). For this reason, we are of the opinion that the aforementioned standards can also be considered equivalent to IFRS for the purposes of Article 2:408 NCC and therefore also to the requirements of the EU Accounting Directive (Directive 2013/34/EU). The requirement of equivalence under Article 2:408 NCC is therefore met in this sense. Incidentally, those decisions refer to the accounting standards prescribed for listed companies in those countries. For unlisted companies from these countries, equivalence has to be assessed on a case-by-case basis on the basis of the specific accounting principles applied.

With the departure, as per 1 January 2021,of the United Kingdom of Great Britain and Northern Ireland (UK) from the European Union, UK GAAP is also a non-EU country accounting system as from this date. UK companies listed on a UK-regulated exchange will continue to have to comply with IFRS as published by the IASB (albeit now to be adopted by the UK itself). On this basis, we believe that UK GAAP can also be considered equivalent to IFRS for the purposes of Article 2:408 NCC. We do note, however, that the European Commission's formal decision to grant UK GAAP (IFRS as endorsed by the UK) equivalence status in EU-regulated markets has yet to take place.

When applying other non-EU accounting standards, it needs to be established that the insight provided by the consolidated financial statements is not materially different from that provided by financial statements based on the requirements of the EU Accounting Directive. In these cases, equivalence should be assessed on a case-by-case basis according to the concrete accounting principles applied. In the Netherlands, EU financial statements are incorporated in Title 9 Book 2 NCC. An important starting point for the analysis of comparability is to consider whether the non-EU accounting system complies with the general provisions and principles set out in Title 9 Book 2 NCC (Section 2) and the EU Accounting Directive (Chapter 2). Its primary concern is whether the financial statements give a true and fair view of the company's assets, liabilities, financial position and profit or loss. The EU Accounting Directive also indicates that if its application is not sufficient to give a true and fair view in the notes to the financial statements, additional information necessary to give a true and fair view should be provided. In Title 9 Book 2 NCC, these regulations are incorporated in Article 2:362 paragraphs 1-4 NCC. The auditor's report covering the consolidated financial statements should also include in the opinion that the consolidated financial statements comply with this true and fair view. It is also important to verify that the management board report has been prepared in a way that is comparable to the requirements of the EU Accounting Directive (Chapter 5) and that the auditor's report states that no material misstatements have been found in this management board report.

In addition, the financial data that the intermediate holding entity would be required to consolidate must be included in full in the consolidated financial statements of the larger entity. It is possible that the intermediate holding entity is itself a joint venture and the data to be consolidated by the intermediate holding is proportionally consolidated in the financial statements of the larger entity. The Dutch Accounting Standards Board clarified that the data to be consolidated by the intermediate holding entity may not be proportionally consolidated in the larger entity because then Article 2:408(1b) NCC (DAS 217.214) is not met. This is due to the requirement that, had the intermediate holding entity had to consolidate, that integral consolidation would be required. Thus, this method must also be applied by the larger entity to qualify for the exemption. The concepts of integral and proportionate consolidation are explained in paragraph 33.5.1.

Other conditions for the exemption from consolidation of a part of a group are that:

- no objection to the entity (intermediate holding entity) has been lodged in writing within six months of the start of the financial year by at least one-tenth of the members or by holders of at least one-tenth of the issued capital;
- the consolidated financial statements with auditor's report and the management board report of the larger entity, insofar as not drawn up or translated into Dutch, are drawn up or translated into French, German or English, all in the same language; and
- within six months of the reporting date or within one month of any permitted subsequent publication, the documents or translations referred to in the previous condition have been filed with the Trade Register (in the Netherlands). This involves the reporting date and permissible subsequent publication of the consolidated financial statements of the larger entity. For example, the consolidating entity may have obtained a deferral for the preparation of its financial statements under legal provisions. There may also be a consolidating entity that is based in a country that applies a longer period for publishing financial statements. If, on this basis, the consolidating entity is not required to publish its consolidated financial statements within six months of the reporting date, the filing deadline under the 408 exemption is also extended. If the consolidating entity under applicable law only publishes a consolidated balance sheet with notes, this will not suffice under the conditions of Article 2:408 NCC. The legislative history shows that full consolidated financial statements (balance sheet and profit and loss account with notes) must be published (DAS 217.214).

Example: Publication of consolidated financial statements of the larger entity later than publication by entity

Intermediate holding entity BV must publish its financial statements for year t within six months of the reporting date according to statutory requirements. Intermediate holding entity BV prepares its financial statements for year t in April of year t+1 and wishes to make use of the exemption of Article 2:408 NCC. The shares of Intermediate Holding BV are held by Parent BV. Parent BV prepares annual consolidated financial statements incorporating in full the financial data of Intermediate Holding Entity BV. Parent BV has obtained a maximum five-month extension from the general meeting to prepare the financial statements for year t. Parent BV is expected to prepare its financial statements for year t in October of year t+1.

Can Intermediate Holding Entity BV make use of the exemption of Article 2:408 NCC to prepare its financial statements for year t?

Yes, provided there is a legitimate expectation that Parent BV will publish consolidated financial statements within the permissible period applicable to it. In that case, Intermediate Holding Entity BV may make use of the exemption of Article 2:408 NCC. In this example, the permissible period for publication of the consolidated financial statements of Parent BV is up to 12 months after the reporting date of Parent BV (statutory period of five months for preparing the financial statements, up to five months' extension and statutory period for publication of up to two months after preparing the financial statements). Obviously, in this situation, the other conditions for application of Article 2:408 NCC must also be met.

If use is made of the exemption of Article 2:408 NCC, the intermediate holding entity does not need to include the assets, revenue and number of employees of group entities to determine which size regime applies (paragraph 2 of Article 2:395a, 396 and 397 NCC). Thus, an intermediate holding entity often qualifies as a small entity. This is important for possible incorporation and publication exemptions and for determining whether an audit is required (see Chapter 1).

It can be inferred from the condition that an auditor's report must be filed with the consolidated financial statements, that these consolidated financial statements must have been examined by a qualified auditor. Therefore, in order to establish the correctness of the application of Article 2:408 NCC, it is desirable for the intermediate holding entity's auditor also to establish that the consolidated financial statements comply with the Seventh EC Directive or meet standards equivalent to those of the Seventh EC Directive.

No exemption for listed intermediate holding entities
A company that has issued listed securities (shares or bonds) cannot make use of the consolidation exemption for intermediate holding entities of Article 2:408 NCC. This is regulated in paragraph 4 of that article and applies to 'an entity whose securities are admitted to trading on a regulated market as referred to in the Financial Supervision Act (Wft) or a system comparable to a regulated market of a state that is not a Member State.'

Moreover, this provision does not only apply to companies listed in one of the EU/EEA Member States subject to supervision. Use cannot be made of the consolidation exemption either when listing in a country outside the EU/EEA with adequate supervision similar to the EU supervisory system, e.g. the New York Stock Exchange. If there is a non-regulated market, for example a multilateral trading facility, use can be made of the exemption.

Change of ownership during the financial year
A condition for using the consolidation exemption of Article 2:408 NCC is that the financial data that the intermediate holding entity would be required to consolidate are included in the consolidated financial statements of a larger entity. In the case of an acquisition during the year, the buyer will consolidate the newly acquired part of the group only from the acquisition date. The question is then whether the intermediate holding entity can benefit from the consolidation exemption of Article 2:408 NCC in the year of acquisition. The legal text is not clear on this. We believe this is possible. There is no requirement as to how such information should be included in the consolidated financial statements. It may be assumed that such data must have been consolidated. In our view, the issue here is that the data should be included in the consolidated financial statements of the larger entity according to the applicable accounting rules.

Example: Acquisition during the year

B BV is the intermediate holding entity of a number of operating companies. A BV is head of the group. On 1 June, Z BV acquires all the shares in the capital of A BV. In doing so, Z becomes head of the group to which Group B (B and its operating companies) belongs. Z should consolidate Group B from the acquisition date of 1 June. B applied the consolidation exemption of Article 2:408 NCC under the former head of the group A. If possible, B wants to continue to apply the consolidation exemption of Article 2:408 NCC in the year of acquisition.

For this, the interpretation of 'the financial data that the entity would be required to consolidate are included in the consolidated financial statements' is relevant (Article 2:408(1)(b) NCC). There is no requirement as to how such information should be included in the consolidated financial statements. It may be assumed that such data must have been consolidated. In our view, the issue here is that, according to the applicable accounting rules (in this case, NL GAAP), the data should be included in the consolidated financial statements of the larger entity. This need not be exactly the same data as the data that B would be required to consolidate.

Indeed, when applying the purchase accounting method, Z must not start from the carrying amounts that B would use for consolidation (see Chapter 31). Z cannot therefore include in its consolidated financial statements the same data that B would be required to consolidate. The financial data of B's operating companies (the acquisition balance sheet as at 1 June, the balance sheet as at 31 December and the profit and loss account for the last seven months of the year of acquisition) are included as such in Z's consolidated financial statements. The profit and loss account data for the first five months of the year of acquisition are included in equity according to the acquisition balance sheet as at 1 June and are included in Z's consolidated financial statements through purchase accounting. Therefore, in our opinion, B can already use the consolidation exemption in the year of acquisition.

Incidentally, it is important that all other conditions of Article 2:408(1) NCC are also met. For example, written objections by at least 10% of shareholders must not have been raised within six months of the start of the relevant financial year (Article 2:408(1)(a) NCC). This means that this intention must have been made known to shareholders within that period.

33.4 Consolidation scope

33.4.1 Consolidation scope of head of group

The consolidation scope indicates which companies should be included in the consolidation. The consolidated financial statements of the head of the group include the financial information of (Article 2:406(1) NCC):

- the head of the group head itself;
- its subsidiaries in the group;
- other group entities under the entity; and
- other entities over which it can exercise control or over which it has central management (this may include SPEs).

Trust Foundation
The so-called Trust Foundation (*Stichting Administratiekantoor*) usually has the general statutory objective of acquiring, managing, and administrating shares against the granting of depositary receipts, for the purpose of management. As a result of this objective, the Trust Foundation exercises the duties of the rights attached to the administered shares, such as voting rights and claim rights. Additionally, the Trust Foundation handles the payment of dividends received and other distributions (including liquidation distributions) to the depositary receipt holders (DAS 640.522). With this certification, the financial and economic rights of the shareholders are separated from the voting rights attached to the shares.

Based on the articles of association of the Trust Foundation, the terms of administration and other specifically agreed provisions, it should be determined whether a Trust Foundation is an extension of the legal entity's own activities (agent) and whether the Trust Foundation is part of the consolidation scope of the entity (DAS 217.309).

An important criterion here is whether the certification of shares has taken place at the initiative of the entity (initiating entity) and whether the entity can appoint or dismiss the management of the Trust Foundation. If this is the case, the certification of shares will generally aim to protect the interests of the voting shareholders associated with the entity. Because the Trust Foundation generally has no assets and liabilities of its own (DAS 640.525), the initiating entity considers it as an extension (agent) of its own activities. Put another way, the group of certificate holders is a third party directly related to the initiating entity. The direct corporate relationship is also visible in the law (Articles 2:102/113/117 NCC). A dividend distribution declared by the legal entity therefore results in a dividend payable to the depositary receipt holders because the Trust Foundation only serves as a 'conduit'. If the Trust Foundation repurchases certificates, these will be accounted for directly in equity of the initiating entity. After all, the cash for the repurchase is in that case provided by the entity and the certificates are repurchased in accordance with its wishes. The Trust Foundation is therefore not a separate group entity that is consolidated, but forms an integral unit with the entity that initiated it.

Trust Foundations can also be established to house employee shares to administer share-related benefits to the employees of the entity. Typically, the entity is the initiatior in establishing the Trust Foundation and the entity has the right to appoint or dismiss the management of the Trust Foundation. In that case, the entity has control over the Trust Foundation and it belongs to the consolidation scope of the entity. If publically traded shares are repurchased by such a Trust Foundation, the entity treats the repurchase of these shares as a direct repurchase of its own shares. We refer to section 14.3.5.

In other situations, it will mainly be necessary to assess whether the Trust Foundation can function independently as a Foundation with respect to the entity. For example, a Trust Foundation may be established where, according to the articles of association, at least half of the board must consist of directors who are independent of the entity. In that case, the statutory purpose of the Trust Foundation will lie more in representing the interests of the depositary receipt holders than in protecting the shareholders of the entity. In this situation, the entity will generally not be able to exercise control over the Trust Foundation and will remain outside the consolidation scope. If the Trust Foundation was not created at the initiative of the entity, there will, as a rule, not be control by the entity. This situation may arise, for example, if some shareholders of the entity, on their own initiative, proceed to certify shares held by them without the knowledge or approval of the management of the entity.

33.4.2 Consolidation scope of intermediate holding entity

The consolidated financial statements of the intermediate holding entity include the financial information of:

- the intermediate holding entity itself;
- its subsidiaries in the group;
- other group entities under the entity; and
- other entities over which it can exercise control or over which it has central management.

33.4.3 Optional limitations on consolidation scope

Article 2:407(1) NCC allows group entities to be excluded from the consolidated financial statements in some cases. This concerns the following optional limitations on the consolidation scope:

Companies to be included in the consolidation whose combined significance is negligible on the whole (Article 2:407(1)(a) NCC)
The text of this article talks about group entities whose joint significance is negligible on the whole. This means that the exemption does not only apply to a single group entity. If the exemption is applied to several group entities, it should be considered whether the totality of these group entities is immaterial. If not, the number of group entities excluded from consolidation should be reduced.

Companies to be included in the consolidation whose necessary information for consolidation purposes can only be obtained or estimated at disproportionate cost or with long delays (Article 2:407(1)(b) NCC)
Only in very exceptional situations will material group entities be able to be excluded from consolidation on this ground. This may occur, for example, after acquiring a new participating interest when the reporting of this participating interest has not yet been adapted to the group's system.

Companies to be included in the consolidation in which the interest is held only for disposal (Article 2:407(1)(c) NCC)
Interests held with the sole intention of disposing of them need not be consolidated. An acquired company is classified as 'held for disposal only' when the following indicators are met on the acquisition date, or within a short period after the acquisition (DAS 217.305):

- the company is fit for immediate disposal;
- a sales decision has been taken and a sales plan has been drawn up;
- implementation of the sales decision and plan has actually begun;
- the selling price is consistent with fair value; and
- it is not expected that the sales plan will be fundamentally altered or withdrawn.

In fact, it must be shown that the interest has been acquired for disposal and that the sale is likely within a year. This may occur if, when acquiring a group or part of a group, there is an intention to reorganise that group and dispose of certain parts. This exception does not cover pre-existing group entities. Group companies for which the intention is to dispose of them in due course generally remain included in the consolidation until the time of actual disposal, unless the company has already ceased to be included in the consolidation scope before then, because the company no longer qualifies as a group entity and there is also no control or central management. The best-known example in which this exception may apply is the situation in which, when acquiring a group or part of a group, buying companies 'as part of the package' – when these are not actually wanted – turns out to be unavoidable and consequently, at the time of the acquisition, there is already the intention to dispose of these unwanted parts as soon as possible. Usually, these indicators are met within three months of the acquisition date. An interest that meets the conditions 'held for disposal only' should be included in current assets (DAS 217.305).

If the sale takes longer than one year due to facts or circumstances beyond the control of the entity and there are sufficient indications that the entity will comply with the sales plan, the interest still remains classified as 'held for disposal only' (DAS 217.306). From the moment the conditions 'held for disposal only' are no longer met, the financial data of the interest should be consolidated with that of the participating entity (DAS 217.307).

Participation entities
For majority shareholdings of participation entities, the exemption of Article 2:407(1)(c) NCC can be applied if, with regard to these shareholdings, a concrete exit strategy has been formulated from the moment of purchase, such that it is clear that these shareholdings are only held with a view to disposing of them at a time defined according to the exit strategy (DAS 217.308). A participation entity is defined as an entity or company whose activity is limited to exclusively or almost exclusively participating in other entities or companies without involving itself in their management, except by exercising shareholder rights (DAS 217.0). If participation entities make use of this exemption, additional disclosure requirements do, however, apply (see paragraph 33.8).

33.4.4 Application of Article 2:407(3) NCC

In the special situation where a group is run by two or more companies (both companies head the group through a mutual arrangement of cooperation), the proprietary financial information (i.e. of the individual heads of the group) may be excluded from the consolidated financial statements (Article 2:407(3) NCC). This exemption from consolidating the entity's own financial data is also referred to as the 'Shell exemption'. In fact, before this exemption was included in Title 9 Book 2 NCC, both parent entities of the Royal/Shell Group at the time were already preparing their financial statements in accordance with this exemption. The two parent entities at the head of the Group are sister entities that have entered into an arrangement of cooperation among themselves. Under Article 2:406 NCC, both parent entities are required to consolidate the entire group. However, Article 2:407(3) NCC allows the parent entities' own financial statements to remain outside the consolidated financial statements of the entire group if the following conditions are met:

- the parent entities have entered into a cooperation arrangement;
- the parent entities have no activities of their own other than managing and financing group entities and participating interests;
- Participating interests are measured at net asset value; and
- the financial information of the other head of the group are also not consolidated.

Example: Application of Article 2:407(3) NCC

The group consists of entities A to H. A and B jointly head the group and have entered into an arrangement to cooperate. A holds 60% of the shares in C and B holds 40% of the shares in C. C holds 100% of entities D to H. A and B have no activity other than managing and financing participating interests. A and B measure participating interest C at net asset value in accordance with Article 2:389 NCC.

A and B have consolidation obligations under Article 2:406 NCC. A and B should prepare consolidated financial statements in which A to H are consolidated. Under Article 2:407(3) NCC, A and B need only include consolidated financial statements incorporating the financial data of C to H (i.e. excluding the financial data of A and B). Thus, if use is made of this exemption, A and B prepare the same consolidated financial statements.

33.5 Principles of consolidation

33.5.1 Integral and proportionate consolidation

Integral consolidation
Companies to be included in the consolidation should be integrally consolidated. When integral consolidation is applied, assets and liabilities, as well as income and expenses, are fully included in the consolidated financial statements. If the interest in the entity is less than 100%, the minority interests in the equity of the consolidated companies are shown separately as part of the group equity on the consolidated balance sheet. Profit or loss attributable to non-controlling interests of consolidated companies are deducted from the group profit or loss and presented as the last item in the consolidated profit and loss account. Instruments containing potential voting rights in the participating interest are not taken into account in determining minority interest. Only rights to economic benefits associated with the activities of the group entity that are present on the reporting date are taken into account (DAS 217.502).

The losses attributable to the third party minority interest may exceed the minority interest in the equity of the consolidated company (usually there is then a negative equity at the participating interest). In that case, the difference, as well as any further losses, will be borne entirely by the majority shareholder, unless and to the extent that the minority shareholder has the obligation, and is able, to bear those losses (DAS 217.508). In fact, in the event of a loss at a group entity with negative equity, the loss will no longer be charged to the item 'Share in profit or loss of participations' in the profit and loss account. If the participating interest subsequently returns to profit, those profits accrue in full to the majority shareholder until the losses attributable to the minority shareholder, which have been borne by the majority shareholder, have been recouped.

Applying the net asset value in the company-only financial statements for the measurement of the participating interest will then often result in a difference between the equity and net profit or loss according to the company-only financial statements and the equity and net profit or loss according to the consolidated financial statements. Such a difference is then disclosed in the company-only financial statements in accordance with the provisions of Article 2:389(10) NCC.

Proportionate consolidation
Besides the integral method, there is also proportionate consolidation. When proportionate consolidation is applied, assets and liabilities as well as income and expenses are recognised in proportion to the equity interest. Proportionate consolidation is only allowed for the recognition of joint ventures in the consolidated financial statements subject to conditions (Article 2:409 NCC) and not for companies included in the consolidation scope pursuant to Article 2:406 NCC. According to Article 2:409 NCC, proportionate consolidation is allowed if:

- in that entity or company, one or more companies included in the consolidation pursuant to a cooperation arrangement with other shareholders, members or partners can jointly exercise the rights or powers referred to in Article 2:24a(1) NCC, i.e. qualifies as a joint venture; and
- this fulfils the legally required insight.

If the conditions of Article 2:409 NCC are met, the integral consolidation method cannot be applied. Proportionate consolidation, incidentally, is only an option if the entity prepares consolidated financial statements. This is clear from the legal text of Article 2:409 NCC ('may be included in the consolidated financial statements').

33.5.2 Uniform accounting principles

Regardless of the consolidation method used, the items in the consolidated financial statements should in principle be prepared in accordance with uniform accounting principles. These are the accounting principles of the entity preparing consolidated financial statements.

If the data of the companies to be consolidated have been prepared on the basis of accounting principles that differ from those used in the consolidated financial statements, these data must be adjusted on the basis of the consolidating entity's accounting policies before being included in the consolidated financial statements, unless the impact of these deviations is not significant. Only for well-founded reasons to be stated in the notes may accounting principles other than those of the consolidating company be used to determine the profit or loss (Article 2:410(3) NCC).

Example: Uniform accounting principles

A transport company has divided its operations into several operating companies. The transport company prepares consolidated financial statements. In addition, each operating company prepares its own financial statements. The management of each operating company chooses its own accounting principles for preparing the financial statements of that operating company. For example, major maintenance is capitalised by one operating company and recognised through a provision for major maintenance by another. Thus, there is no consistent course of action between the operating companies. The consolidated financial statements should be based on a uniform accounting policy unless the impact of different accounting principles is not important. This means that the figures of operating companies using different accounting principles have to be recalculated for consolidation purposes. Clearly, within a group, individual operating companies using different accounting principles – although permitted – is not practical.

Another exception is where a foreign entity is the joint head of the group. Article 2:410(4) NCC allows the part of the group headed by the foreign entity to be consolidated under the law of that foreign entity. The impact of this on equity and profit or loss should be disclosed.

33.5.3 Elimination of relationships and profit or loss

All relationships between companies included in the consolidation should be eliminated in the consolidated financial statements. This relates to mutual shareholdings, receivables, payables and intercompany transactions. Profits or losses on intercompany transactions between consolidated companies should be eliminated in both the balance sheet measurement and profit or loss insofar as the profits or losses have not been realised through transactions with third parties outside the group. See Chapter 15 for how to recognise intercompany profits and losses.

33.5.4 Reporting date

The reporting date for the consolidated financial statements is the same as the reporting date for the company-only financial statements. However, data used in consolidation may have a different reporting date, but this deviation may not exceed three months (Article 2:412(2) NCC). Unrecognised movements in this period that would distort the group's balance sheet or profit and loss account should be recognised in the consolidated statements (DAS 217.506).

Example: Subsidiary's different reporting date

A subsidiary has a financial year ending 30 September of year 1. The subsidiary has a loan with a repayment obligation on 1 October of year 2. The debt was correctly presented as non-current debt in the subsidiary's financial statements. The subsidiary is included in the consolidated financial statements of the parent entity. These financial statements have 31 December as their reporting date. Due to the time difference, the repayment obligation of the debt on 31 December of year 1 is payable within one year. Debt classification should be determined by reference to the parent entity's reporting date. This results in the consolidated financial statements classifying the debt as current debt as repayment is due nine months after the end of the parent entity's financial year.

33.6 Consolidation on acquisition and disposal of companies to be included in the consolidation

Acquisition of companies
The profit or loss of companies acquired during the year and to be included in the consolidation shall be recognised in the group profit or loss to the extent they have been achieved after the time of acquisition (DAS 217.402). The time of acquisition is the time at which the company qualifies as a company to be included in the consolidation. This date may differ from the date when the purchase contract was concluded or the date from when the company is contractually deemed to have been held (with or without retroactive effect) for the acquirer's own account. See also Chapter 31 on mergers and acquisitions. For practical reasons, such as the availability of financial data, it is acceptable to recognise the profit or loss of an acquired company in the group profit or loss from a point in time other than the time at which decisive influence was obtained, provided that this does not have a material impact on equity and profit or loss.

Disposal of companies
Companies that are disposed of will in principle remain included in the consolidation until the time of disposal, unless at an earlier point in time the company no longer qualifies as a company to be included in the consolidation. Once a company no longer qualifies, it should no longer be included in the consolidation. As long as consolidation takes place, the consolidated financial statements are not allowed to take into account at this stage the effects of possible future deconsolidation (DAS 217.304).

Pro forma restatements
For ease of understanding, a restated profit and loss account can be prepared as a note to the financial statements, recognising the newly acquired associates for the full year (DAS 217.402). If such a pro forma restatement is added, possible changes in finance costs and taxes that would have occurred if the acquisition had already taken place at the beginning of the financial year should be taken into account. With regard to participating interests disposed of during the year, information can be provided in a similar way with a pro forma restatement.

33.7 Changes in size of controlling interest while maintaining control

A special situation arises if the parent entity sells or acquires a minority interest, while retaining a controlling interest (i.e. control) both before and after the transaction. From a consolidated perspective, this means that parent shareholders enter into transactions with minority shareholders of consolidated subsidiaries. The Dutch Accounting Standards do not explicitly address the recognition of such transactions. In our view, the method of recognition depends on the view of the perspective of the consolidated financial statements:

- if the consolidated financial statements are regarded as those of the group as an economic entity ('economic entity concept'), then the transactions will be labelled as transactions between group shareholders and will therefore be recognised within group equity. This is the method IFRS prescribes;
- if the consolidated financial statements are seen as an extension of the parent ('parent company extension concept'), then the shareholders of the parent enter into transactions with 'third parties' that could, in principle, lead to a profit or loss (in the event of a sale of part of the interest), or recognising goodwill (in case of extension of the interest).

We consider both methods of recognition acceptable within NL GAAP. However, the recognition of the purchase and sale of a minority interest in an existing controlling interest should, in our opinion, be recognised consistently, as part of the accounting policies used by the entity. In other words: when it comes to transactions with minority shareholders while retaining control, the company should consistently recognise these in the consolidated financial statements, using either of the above concepts.

Below, we elaborate on the transactions, distinguishing between (1) acquisitions of a minority interest and (2) sales of interests to minority shareholders, respectively.

Acquisitions of a minority interest while retaining control
In the following example, we assume an acquisition of a minority interest, while retaining control, from the perspective of both concepts mentioned above ('economic entity concept' and 'parent company extension concept').

Example: Acquisition of minority interest

Entity A owns 90% of the shares of entity B. The measurement of participating interest B in A's company-only financial statements is at net asset value. As at 31 December of any year (reporting date), the equity of associate B based on A's accounting principles is 1,000. The value of the participating interest in A's company-only financial statements is 90% of 1,000 or 900 (net asset value). In A's consolidated financial statements, B is consolidated (in full), resulting in a minority interest of 10%.

On the reporting date, A buys the remaining 10% of B's shares (the minority interest) for an amount of 150.

One method of recognition (following from the 'parent company extension concept') is to consider the difference between the acquisition cost of this 10% interest (= 150) and the minority shareholder's interest in the assets and liabilities (= 100, i.e. 10% of 1,000) as shown in the consolidated financial statements at the time of acquisition as goodwill (= 150 - 100).

This is recognised in the consolidated financial statements as follows:

Goodwill (= 150 - 100)	50	
Minority interest (= 10% of 1,000)	100	
Bank (or debt)		150

To illustrate, we also provide the recognition in the company-only financial statements:

Goodwill (= 150 - 100)	50	
Participating interest B (= 10% of 1,000)	100	
Bank (or debt)		150

This method of recognition is also consistent with the view that there is no change in the already 100% consolidated assets and liabilities (there was already control).

An alternative method of recognition (prescribed by IFRS) is to treat the buyout of the minority shareholder as a transaction between the group entity (in this case A and its consolidated associates) and the (minority) shareholders of that entity. In that case, the difference between the acquisition cost (150) and the minority shareholder's interest in the entity's assets and liabilities (100) is recognised in group equity. This method of recognition follows from the economic entity concept in which the minority interest is considered part of the group's equity.

This is recognised in the consolidated financial statements as follows:

Equity attributable to shareholders of A (= 150 - 100)	50	
Minority interest (= 10% of 1,000)	100	
Bank (or debt)		150

The recognition in the company-only financial statements is as follows:

Equity (= 150 - 100)	50	
Participating interest B (= 10% of 1,000)	100	
Bank (or debt)		150

Under this method, therefore, no goodwill arises and the transaction is effectively seen as a transaction between the shareholders of the group which A heads.

The recognition in the company-only financial statements assumes that the separate equity remains the same as the consolidated equity. Incidentally, we consider it acceptable (also in this example) to capitalise goodwill in the *company-only* financial statements because the economic entity concept relates to consolidated recognition. Indeed, the company-only financial statements may highlight the investment nature of the acquisition from parent A's point of view. This is because seen from a company-only view, there is an increase in the equity interest in entity B (from 90% to 100%). The recognition in the company-only financial statements is then according to the 'parent company extension concept' as shown above.

However, if combination 3 is applied, the 'economic entity concept' should be continued in the company-only financial statements (DAS 214.312b). After all, under combination 3, the company-only financial statements apply the measurement bases that the entity applies in the consolidated financial statements under IFRS. In this way, reconciliation is maintained between consolidated and company-only equity.

Selling interests to minority shareholders while retaining control

In the following example, we assume a disposal of an interest, again while retaining control, from the perspective of both concepts ('economic entity concept' and 'parent company extension concept').

Example: Sale of minority interest

Entity A owns 100% of the shares in entity B. The measurement of participating interest B in A's company-only financial statements is at net asset value. As at 31 December of any year (reporting date), the equity of associate B based on A's accounting principles is 900. There is no goodwill relating to B in A's consolidated and company-only balance sheet. Subsequently, A sells 30% of its shares in B for a sum of 300.

One method of recognition (following from the parent company extension concept) is to consider as a book profit the difference between the consideration for this 30% interest (= 300) and the minority shareholder's interest in the assets and liabilities (= 270, i.e. 30% of 900) as shown in the consolidated financial statements at the time of the sale.

This is recognised in the consolidated financial statements as follows:

Bank	300	
Non-controlling interest (= 30% of 900)		270
Profit on sale of interest in B		30

The recognition in the company-only financial statements is as follows:

Bank	300	
Participating interest B (= 30% of 900)		270
Profit on sale of interest in B		30

An alternative method of recognition (prescribed by IFRS) is to treat the entry of the minority shareholder as a transaction between the group entity (in this case A and its consolidated subsidiaries) and the (minority) shareholders of that entity. In that case, the difference between the consideration (300) and the minority shareholder's interest in the entity's assets and liabilities (270) is recognised in group equity. This method of recognition follows from the economic entity concept in which the minority interest is considered part of the group's equity.

This is recognised in the consolidated financial statements as follows:

Bank	300	
Non-controlling interest (= 30% of 900)		270
Equity attributable to parent's shareholders		30

There is actually a gain by the parent's shareholders over the net asset value amounting to 30. This gain therefore increases the equity attributable to the parent's shareholders. In this concept, transactions between the economic entity and its shareholders are recognised within equity (and not in the profit and loss account).

The recognition in the company-only financial statements is as follows:

Bank	300	
Participating interest B (= 30% of 900)		270
Equity		30

Moreover, we consider it acceptable (even with this alternative method of recognition) to recognise book profit in the *company-only* financial statements because the economic entity concept relates to consolidated recognition. Indeed, in the company-only financial statements, the divestment nature of the sale can be emphasised from parent A's point of view. After all, from a company-only point of view, there is a sale of the interest in B (from 100% to 70%). The recognition in the company-only financial statements is then according to the 'parent company extension concept' as shown above.

However, if combination 3 is applied, the 'economic entity concept' should be continued in the company-only financial statements (DAS 214.312b). After all, under combination 3, the company-only financial statements apply the measurement bases that the entity applies in the consolidated financial statements under IFRS. In this way, reconciliation is maintained between consolidated and company-only equity.

33.8 Changes in the size of controlling interests with loss of control while maintaining a residual interest

If control is lost on the sale of an interest, but an interest is still retained, a different situation from the one described in the previous paragraph occurs. The assets and liabilities of the controlling interest are deconsolidated and a residual interest is recognised in its place. Under IFRS, the residual interest still held is remeasured to fair value at the time of deconsolidation. From the '*economic entity concept*' it is actually reasoned that first a controlling interest is sold (leaves the economic entity), after which a different kind of interest is bought back. The initial measurement of this 'repurchased' interest should take place at fair value. Any profit or loss is recognised in the consolidated profit and loss account. There are no explicit provisions in the Dutch Accounting Standards on how to recognise this type of transaction. This has the consequence that, in our opinion, different methods of recognition are possible. The examples below illustrate these.

Example: Sale of part of controlling interest resulting in loss of control

Entity A owns 70% of the shares in entity B and thus has control. A sells 60% of its shares in B for a sum of 600. The total carrying amount of the interest in B (100%) is 900. The fair value of the entire 100% interest in B is 1,000.

In the consolidated financial statements, the sale can be recognised as follows:

Investment in B (at fair value = 10% of 1,000)	100	
Bank	600	
Non-controlling interest (= 30% of 900)	270	
Consolidated assets and liabilities		900
Profit on sale of interest in B		70

The profit amounting to 70 concerns the difference between the selling price of 600, plus the fair value of the remaining investment (10% interest) amounting to 100 on the one hand, and the carrying amount of the share in assets and liabilities amounting to 630 (= 70% of 900) on the other hand. This method of recognition is mandatory under IFRS. A revaluation reserve must also be created equal to the increase in value of the existing interest of 10 (= 100 - 90), unless frequent market quotations exist for the B shares (Article 2:390(1) NCC).

In our opinion, it is also possible to opt for a method of recognition where no profit is taken on the residual interest. This is on the basis that the company still has an economic interest in part of the original interest in B. Put another way, the increase to fair value of the remaining 10% interest is not recorded because it is considered unrealised.

Investment in B (at existing carrying amount = 10% of 900)	90	
Bank	600	
Non-controlling interest (= 30% of 900)	270	
Consolidated assets and liabilities		900
Profit on sale of interest in B		60

The profit amounting to 60 concerns the difference between the selling price of 600 on the one hand, and the carrying amount of the sold share of assets and liabilities amounting to 540 (= 60% of 900) on the other hand.

If the investment is henceforth measured at fair value through the profit and loss account (see paragraph 21.6.4.2), in our opinion, the first method of recognition (mandatory under IFRS) is the most obvious one. Under that method of recognition, the initial measurement of the investment in B is also at fair value. In that case, only changes in fair value are recognised in the profit and loss account in the subsequent measurement, in accordance with the relevant measurement basis. Under the second method of recognition and subsequent measurement at fair value through the profit and loss account, the subsequent measurement would recognise 10 profit not resulting from an increase in fair value. This is less obvious.

33.9 Presentation requirements and exemptions for consolidated financial statements

Title 9 Book 2 NCC

The provisions of Title 9 Book 2 NCC on financial statements apply almost entirely by analogy to the consolidated financial statements. Article 2:410(1) NCC lists the following exemptions for consolidated financial statements:

- creating a legal reserve in the amount of capitalised incorporation costs and costs of issuing shares, and capitalised development costs (Article 2:365(2) NCC);
- equity movement schedule (Article 2:378 NCC);
- disclosure of information on participating interests (Article 2:379 NCC);
- disclosure of auditor's fees (Article 2:382a NCC);
- disclosure of details of remuneration to and loans, advances and guarantees for the benefit of (former) management board members and supervisory directors (Articles 2:383 and 2:383b to 2:383e NCC);
- creating a reserve for participating interests (Article 2:389(6) NCC);
- creating a foreign currency translation reserve (Article 2:389(8) NCC); and
- creating a revaluation reserve for remeasured assets (Article 2:390 NCC).

Profit and loss account

In the company-only profit and loss account, only the profit or loss from participating interests needs to be shown as a separate item by the consolidating company, provided its own data are included in the consolidation. The notes to the consolidated financial statements should disclose that use is being made of this exemption (Article 2:402(1) NCC). Entities classified as public interest entities (see paragraph 1.1.1) cannot benefit from the group exemption (Article 2:402(2) NCC).

Staff information

The information on the average number of employees employed during the financial year are given for all the companies fully included in the consolidation. In addition, the average number of employees should be disclosed separately for the whole of the proportionately consolidated companies (Article 2:410(5) NCC).

Inventory

Inventory need not be broken down if doing so would entail disproportionate costs due to special circumstances (Article 2:410(2) NCC). This could include a situation where the breakdown in the consolidated financial statements is made in a different way from that in a group entity. End products from one group entity may, for example, be raw materials for another group entity.

Group equity and profit or loss
With regard to group equity and group profit or loss, Article 2:411 NCC stipulates the following:

- breakdown of equity is not mandatory. It is preferable not to break down the consolidated equity given the purpose of the consolidated financial statements; and
- the share in the group equity and consolidated profit or loss that is not attributable to the entity must be disclosed.

Differences in the equity (and profit or loss) according to the company-only and consolidated financial statements of the entity must be disclosed in the notes to the company-only financial statements (Article 2:389(10) NCC).

Group companies and participating interests
Article 2:414(1) NCC requires the financial statements to list the name and residence of the companies included in the consolidation, the proportionately consolidated joint ventures, and the associates that are recorded on the balance sheet at net asset value. See also annex 1 of Chapter 9.

The notes to the financial statements should disclose the basis on which consolidated participating interests in which the entity does not hold the majority of voting rights have been included in the consolidation. If participating interests in which a majority of voting rights is exercised are not included in the consolidation, the reason should be disclosed.

With regard to proportionately consolidated companies, it should also be disclosed on what basis proportionate consolidation has taken place.

33.10 Disclosure

Non-controlling interest
If it is necessary for providing the required insight, an entity should disclose in the notes to the consolidated financial statements information on the non-controlling interest in the group. This can be done, for example, by providing insight into the share of third parties in the nature and extent of items on the balance sheet and profit and loss account. According to the Dutch Accounting Standards Board, this is particularly important where the risk profile, return profile or liquidity profile for an activity in which third parties participate is significantly different from the group as a whole (DAS 217.602).

Disclosure of equity interests
For the disclosure of equity interests (in accordance with Articles 2:379 and 414 NCC), please refer to Annex 1 to Chapter 9. One of the requirements is that the reason for not consolidating a subsidiary must be disclosed (Article 2:414(2)(c) NCC). In addition, the circumstance by virtue of which a company has been fully consolidated must be disclosed, unless that circumstance consists of the ability to exercise the majority of the voting rights and providing a proportionate share of the capital (Article 2:414(2)(a) NCC). As an elaboration of and in addition to this, the Dutch Accounting Standards Board has stipulated that an explanation must be given as to why a company is or is not included in the consolidation, in case this is not evident on the basis of the equity interest held. This may be the case, for example, when the entity provides more than 50% of the capital but does not actually have control. Or where the entity provides less than 50% of the capital but does have control (DAS 217.601).

Disclosure of equity interests by participation entities
Participation entities using the consolidation exemption of Article 2:407(1)(c) NCC (see paragraph 33.4.3) must disclose its application and the reason for it (DAS 217.308). In addition, these participation entities must disclose the information on equity interests as referred to in Article 2:379(1) NCC of each company to which at least one-fifth of the issued capital is provided directly or indirectly through or together with subsidiaries (DAS 217.308b). This includes equity interests in which the participation entity itself (in a company-only capacity) does not directly hold an interest.

For these equity interests, the participation entity must also disclose (DAS 217.308c):

- what arrangements or restrictions are in place for these interests to transfer funds to the entity in the form of dividend or loan or advance repayments;
- what arrangements or intentions there are for the entity to provide financial support to those interests, including arrangements or intentions to assist those interests in obtaining financial support; and

- the reasons for providing financial support or assisting in obtaining financial support (in addition to the nature and extent of the agreements, restrictions or intentions).

Application of exemption for intermediate holding entities (Article 2:408 NCC)
Entities making use of the consolidation exemption for intermediate holding entities of Article 2:408 NCC (see paragraph 33.3.2), must disclose its application (Article 2:408(3) NCC).

33.11 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

For small entities, consolidation is not required if the conditions of the consolidation exemption for small groups are met (Article 2:407(2) NCC). See paragraph 33.3.1.

33.12 Significant differences from IFRS

Personal holding
Under NL GAAP, a personal holding entity that does not qualify as the head of a group is not required to prepare consolidated financial statements. IFRS 10 ‘Consolidated Financial Statements’ does not recognise the concept of a personal holding and therefore contains no provisions to exempt such a holding entity from the requirement to consolidate subsidiaries.

Consolidation exemptions for small entities
IFRS 10 has no exemption from the consolidation requirement for small groups. Under Title 9 Book 2 NCC, an exemption from the consolidation obligation applies to an entity that heads a small group.

Acquired interests held temporarily
Under IFRS, entities that are not classified as investment entities must consolidate their interests in which there is 'control' ('subsidiary'). The same applies to an acquired 'subsidiary' only held for disposal in the foreseeable future. Under NL GAAP (Article 2:407(1)(c) NCC) such interests need not be consolidated by an entity.

Subsidiaries to be divested
IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' applies when a 'subsidiary' is classified as held for sale. In that case, a 'subsidiary' is consolidated but the presentation is adjusted on the balance sheet. The total assets of such a 'subsidiary' are then presented as one item under current assets and the total liabilities of the 'subsidiary' as one item under current liabilities. Under NL GAAP, such a method of presentation is not allowed.

Consolidation obligation for participation entities
Under NL GAAP, participation entities and investment entities can choose to apply the exemption of Article 2:407(1) NCC for controlling interests. A condition is that a concrete exit strategy is formulated for these participating interests from the time of purchase, such that it is clear that these participating interests are held only for the purpose of disposing of them at a defined point in time according to the exit strategy.

Under IFRS, investment companies do not consolidate their interests in 'subsidiaries'. Subsidiaries that provide investment activity services to the investment company itself and do not classify themselves as investment companies are, however, consolidated. An investment company is an entity that (IFRS 10.27):

a. obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
b. undertakes to its investor(s) to invest the funds obtained solely for the purpose of obtaining returns from capital growth, investment income, or both; and
c. measures and evaluates the performance of almost all its investments on a fair value basis.

This assessment should take into account all the facts and circumstances. It must be established whether an entity possesses the three elements of the definition of an investment company. IFRS 10 elaborates on those three elements through the following aspects:

- the business purpose of the entity;

- the entity's exit strategies;
- the profit or loss from investments;
- the measurement of investments at fair value.

Exemption from consolidation obligation for intermediate holding entity
IFRS 10, like NL GAAP, has an exemption for consolidation obligations of an intermediate holding entity. However, the conditions for being allowed to apply an intermediate holding entity's consolidation exemption are not entirely the same. An important difference is that according to Article 2:408 NCC, the consolidated financial statements that the larger entity must file should be prepared in accordance with the requirements of the EU Accounting Directive (Directive 2013/34/EU) or, if these requirements do not have to be followed, in an equivalent manner. IFRS 10 requires consolidated financial statements prepared in accordance with IFRS.

Attributing losses to minority interest
IFRS 10 provides that losses are always allocated proportionately to the minority interest (‘non-controlling interest’). This is also mandatory if this brings the minority interest to less than nil. Here, it is irrelevant whether the minority shareholder has assumed liability for the debt of its participating interest. Under DAS 217, losses are borne entirely by the majority shareholder when the minority interest falls below nil, unless and to the extent that the minority shareholder has the obligation, and is able, to bear those losses.

Changes in size of controlling interests where control is retained
IFRS 10 provides that changes in the size of controlling interests after control is obtained and where the changes do not result in the loss of this control are recognised as transactions with shareholders within equity in the consolidated financial statements. This means that no profit or loss on these transactions can be realised in the consolidated financial statements. There are no explicit provisions on this under NL GAAP. This has the consequence that different methods of recognition are possible. See the examples given in paragraph 33.7.

Sale of controlling interest while retaining minority interest
Under IFRS, if control is lost on the sale of a partial interest, the interest still held is remeasured to its fair value at that time. Any profit or loss is recognised in the consolidated profit and loss account. There are no explicit provisions on this under NL GAAP. This has the consequence that different methods of recognition are possible. See the example in paragraph 33.8.

34 Joint ventures

34.1 Introduction

A joint venture is an entity in which a limited number of parties have joint control as a result of a cooperation agreement (DAS 215.0). A fundamental requirement for a form of cooperation to qualify as a joint venture is that there is joint control. This means that none of the parties, or joint venturers, exercise control over the activities of the other party/parties. Whether a form of cooperation qualifies as a joint venture is determined by the joint venturers' relative control relationships and not, therefore, their relative ownership interests or their designation as such (DAS 215.202). Therefore, the extent to which the joint venturers bear risk or are entitled to profit is not decisive for determining whether or not their cooperation is a joint venture. Of course, this does provide an indication of the degree of influence they have. One requirement for an entity to qualify as a joint venture is that there is a cooperation agreement and, as stated, none of the parties to it has dominant control. If one joint venturer does have dominant control, the entity is not a joint venture. Therefore, the entirety of the cooperation agreement has to be assessed to determine whether the entity is a joint venture.

The term joint venture is sometimes used for forms of cooperation that do not meet the definition of a joint venture given by DAS 215.0. This is the case if, for example, one joint venturer is able to take or enforce policy decisions. In that case, the entity is a group entity and that particular joint venturer should apply integral consolidation (see Chapter 33). Given that this form of cooperation is not subject to joint control, for the other joint venturers it classifies then (very likely) as a participating interest and should be recognised as such in their financial statements.

34.2 Forms of joint ventures

Introduction
There are various forms of joint ventures, for example a professional partnership (*maatschap*), a general partnership (*vennootschap onder firma* ('VOF')), limited partnership (*commanditaire vennootschap* ('CV')), public limited liability entity (*naamloze vennootschap* ('NV')), private limited liability entity (*besloten vennootschap* ('BV')) or a cooperative. Therefore, a joint venture need not necessarily take the form of a joint legal entity. The terms 'equity joint venture' and 'contractual joint venture' are also used in this context.

Joint ventures can therefore exist in the following situations:

- cooperation in the form of an entity or partnership;
- cooperation in the form of conducting joint activities using certain assets of the joint venturers, with each venturer itself retaining sole control over (and often ownership of) those assets. One example of such a situation is when two different companies use part of their production capacity to jointly manufacture a certain product where they each bear responsibility for part of the production process; and
- cooperation in the form of conducting joint activities using assets that the joint venturers jointly control (and often also jointly own). One example of such a situation is when two oil companies jointly own and use a pipeline to transport their own oil products.

Joint ventures in the form of entities or companies incorporated under foreign law
Joint ventures can also be in form of entities or companies incorporated under foreign law, such as 'limited' companies under English law or 'corporations' incorporated under the laws of Delaware in the United States. In this regard, foreign entities that have share capital, in particular entities incorporated under the laws of a non-EU member state country (e.g. Delaware corporations) may be subject to the Formally Foreign Companies Act (*Wet op de formeel buitenlandse vennootschappen* (WFBV)) in the process.

According to this act, such entities are subject to more or less the same administrative obligations as Dutch private limited liability entities (including financial statement obligations) if they have no actual connection with the state under whose law they are incorporated and operate almost entirely in the Netherlands.

Managing partner in a general or limited partnership
A general partnership (*vennootschap onder firma*) is a professional partnership that conducts business under a shared name. A limited partnership (*commanditaire vennootschap*) is a partnership in which the limited (or silent) partners act merely as lenders and, as long as they do not perform any acts of management with external effect, are not liable beyond the amount of their contribution. In a general partnership, each partner is authorised to carry out acts that

have external legal effect for the partnership. Managing partners in a limited partnership have the same powers as partners in a general partnership.

A limited partnership may have managing as well as limited partners. Like a partner in a general partnership, a managing partner in a limited partnership is liable for debts incurred by that partnership. If an entity is a managing partner of a general or limited partnership, that entity must consider the partnership as a subsidiary (Article 2:24a(2) NCC). That entity also has a participating interest in that partnership (Article 2:24c(2)(a) NCC).

Whether a general partnership or limited partnership should also be considered a group entity and therefore consolidated, is determined by the normal criteria of DAS 217.2. The entity must have *de facto* control of the general or limited partnership's policy. If managing partners have entered into joint venture agreements with other partners of a limited partnership or a general partnership, thus giving them *de facto* joint control, those managing partners must account for that partnership as a joint venture and, therefore, it does not qualify as a group entity.

Limited partner in a limited partnership
Limited partners may not perform management acts with external effect or be employed by the partnership. In principle, a limited partner merely provides capital to the partnership. If an entity has a participating interest in a limited partnership as a limited partner in order to be permanently associated with it for the benefit of its own operations, that interest qualifies as a participating interest (Article 2:24c(2)(b) NCC). In addition, the same applies as has been stated for managing partners. In a situation of joint control, both managing and limited partners run a joint venture and should therefore account for it as a joint venture in the financial statements.

Interest in a professional partnership
A professional partnership (*maatschap*) is an agreement between two or more individuals to produce something together with intention of sharing the resulting benefit with each other. The legislator proceeds from the assumption that each partner is individually authorised to conduct acts of management. Although it has not made any rules about control, it should be assumed that, in practice, acts of disposition require the cooperation of all partners. This means that joint ventures may also be run in the form of professional partnerships. Joint control is then evidenced by a partnership agreement. See also Chapters 9 and 33 for the recognition and measurement of equity interests.

34.3 Recognition

34.3.1 Recognition of joint ventures in the form of entities or partnerships

Company-only financial statements
None of the parties to a joint venture exercise dominant control. In practice, they do have significant influence over business and financial policies. Each venturer therefore measures their participation in a joint venture according to the net asset value method in the company-only financial statements unless use is made of the exception provision provided for in Article 2:389(9) NCC (see also Chapter 9).

Consolidated financial statements
In principle, joint ventures in the form of entities that have capital or partnerships in which at least two entities or companies participate on an equal footing are not considered as group member because they do not meet the criterion of control. Therefore, joint venturers may not apply the integral consolidation method prescribed for group entities.

According to Article 2:409 NCC, the financial information of an entity or partnership (...) may be included in the consolidated financial statements in proportion to the interest held in it if there is an arrangement for cooperation and the recognition applied meets the insight requirement. The joint venture may therefore be accounted for using either the proportionate consolidation method referred to in that article or the net asset value method. According to Article 2:409 NCC, however, the proportionate consolidation method may only be used in joint-venture relationships if it meets the legal insight requirement. The proportionate consolidation method may obviously only be used if the joint venture is in the form of an entity or a partnership. If it is not, then proportionate recognition is applied as described in paragraph 34.3.2.

The question is then how to consolidate if the financial entitlement of a joint venturer is different from their relative equity interest in that joint venture, or if the relative control of a joint venturer deviates thereof. Relative control is essential in determining whether the joint venture qualifies as a group entity for the parties to it. Incidentally economic entitlement is a major indicator of this. However, a joint venture is always recognised on the basis of economic entitlement.

Example: Recognition of a joint venture

Two parties (A and B, both being private limited liability entities) together set up a joint venture. Under the joint venture agreement, they have equal influence. However, A and B have a 60% and 40% entitlement, respectively, to the profit or loss of the joint venture. This is because A makes a significant effort in achieving this profit or loss. In that case, the joint venture is not a group entity of either party, as they have equal control. A accounts for the joint venture using the proportionate consolidation method (60% of assets, liabilities, income and expenses), or as a participating interest at net asset value (60% of net asset value).

34.3.2 Accounting for joint ventures in the form of other partnerships

Where a joint venture carries out activities collectively, the assets it uses should be fully recognised in the financial statements of the party who controls them. This also applies to the liabilities incurred by that venturer, the expenses they incur and their share of the profit or loss on sales and/or services provided by the joint venture.

Where a joint venture carries out activities collectively, uses assets that are jointly controlled by the joint venturers, those joint assets as well as joint liabilities, revenue and costs are recognised proportionately in each of the parties' financial statements.

34.4 Transactions between joint venturers

34.4.1 Initial measurement in the joint venture financial statements

Assets and liabilities contributed by the joint venturers are initially measured at fair value at the time of contribution in the joint venture financial statements (DAS 215.210). This fair value is considered as the purchase cost of assets and liabilities for the joint venture.

34.4.2 Subsequent measurement in the joint venture financial statements

Subsequent measurement depends on the method chosen. To the extent possible, the basis for measurement and determination of profit or loss will in practice be the same as that applied by the joint venturers themselves.

34.4.3 Accounting treatment in the financial statements of the joint venturers

Recognition of gain on assets transferred to the joint venture

Establishing a joint venture often entails the joint venturers transferring productive assets to it. As stated, the joint venture itself recognises these assets at fair value in the balance sheet. The question is whether the joint venturers may recognise profit on these transferred assets. The Dutch Accounting Standards Board authoritatively states that they may only recognise such profit to the extent of the interest held by the other venturers, on condition that the assets in question are still held by the joint venture and that the venturer in question has transferred the material risks and rewards of ownership. However, they may not recognise any profit or loss if the non-monetary assets contributed by the venturers are approximately equal as regards their nature, use and fair value (DAS 215.208).

Example: Recognition of joint venturer's transaction with the joint venture

A joint venture (C) has two venturers (A and B) who each have a 50% interest. A sells inventory to C. The joint venture does not immediately resell it to third parties. The carrying amount of inventory at A is 100. The fair value is 200. C pays 200 to A. The question is how A should recognise this transaction.

If A proportionally consolidates the joint venture, A recognises it as follows (which includes the effect of proportionate consolidation):			
Cash	200		
Share of C's inventory	50		(= 50% of (200 - 100)) (= unrealised gain on transaction))
Share of C's cash		100	(= 50% of 200)
Inventory		100	(= inventory's carrying amount)
Profit on transaction		50	(= gain on disposal of 100 minus unrealised gain of 50 on transaction)
If A does not proportionally consolidate the joint venture but applies the net asset value method, recognition is as follows:			
Cash	200		
Inventory		100	
Participating interest in the joint venture		50	(= share of cash belonging to C which is 50% of 200 minus share of decrease in inventory of C which is 50% of 100)
Profit on transaction		50	

Recognition of loss on assets transferred to joint venture
A joint venturer recognises the full amount of any losses on assets transferred to the joint venture if the contribution or sale shows a reduction in the net realisable value of current assets or an impairment loss.

Recognition of unaccounted for portion of profit
Any unaccounted for profit should be deducted from the carrying amount of related assets in the case of proportionate consolidation and from the net asset value of the joint venture if it is not consolidated. This profit should not be deferred as an unrealised profit (DAS 215.208).

Joint venturer's share of joint venture profit in an upstream sale
If a joint venturer purchases assets from their joint venture (a so-called upstream sale), they do not recognise their share of the joint venture's profit from the transaction until they have resold those assets to an independent party. A joint venturer recognises their share of losses from such transactions in the same way as gains, except that losses are recognised immediately if they represent a reduction in the net realisable value of current assets or an impairment loss (DAS 215.209).

34.5 Presentation and disclosure

The legal requirements for presentation and disclosure in relation to joint ventures are set out in Articles 2:379 and 2:414 NCC. According to Article 2:379 NCC, the entity states the name, domicile and the share contributed to the issued capital of each company to which it, for its own account and solely or jointly with one or more subsidiaries, contributes at least one fifth of the issued capital. If the entity does not consolidate the joint venture but treats it as a participating interest, then, in principle, equity and the profit or loss according to the joint venture's latest financial statements must also be disclosed. This may be omitted if the joint venture is measured at net asset value (which will often be the case).

According to Article 2:414(2)(b) NCC, it must be stated why an entity or partnership whose financial information in accordance with Article 2:409 NCC has been proportionally included in the consolidated financial statements qualifies for that. In other words: if the joint venture is proportionally consolidated, there is a legal duty to disclose in the notes why the joint venture qualifies for proportional recognition.

If the entity applies the accounting principle that joint ventures are proportionally consolidated, that measurement basis must be evident from the explanation of the entity's consolidation principles. In that case, the requirement of a consistent application also applies.

In principle, whether the joint venture is incorporated or unincorporated is irrelevant to the decision whether or not to apply proportionate consolidation.

34.6 Exemptions for small and medium-sized entities

There are no exemptions for medium-sized entities.

Small entities need only include the information required by law in the notes. In addition, they may consider including additional information (over and above the legal minimum) in the notes.

34.7 Significant differences from IFRS

Joint ventures in the consolidated financial statements
Under the Dutch Accounting Standards, there is a joint venture in the case of activities, whether or not carried out in the form of an entity or partnership, over which control is exercised jointly as a result of a cooperation agreement between a limited number of parties. In line with Dutch law, the Dutch Accounting Standards state that proportionate consolidation is allowed for the recognition of joint ventures in the consolidated financial statements if this meets the legal insight requirement. If proportionate consolidation is not applied, the joint venture is recognised at net asset value (unless the entity uses Article 2:389(9) NCC to apply a different accounting principle, based on justified reasons to be disclosed in the explanatory notes).

Under IFRS, there is a joint arrangement when two or more parties have joint control. According to IFRS 11 'Joint Arrangements' joint arrangements should be classified as either a joint venture or a joint operation. A joint venture is an arrangement in which the parties, having joint control of that arrangement, have rights to the net assets of the arrangement. A joint operation is an arrangement in which the parties that jointly control the arrangement have rights to the arrangement's assets and are responsible for their liabilities. A joint venturer recognises their interest in a joint venture using the equity method. A joint operator recognises their interest in a joint operation by recognising their interest in its assets, liabilities, revenue and expenses. This resembles proportionate consolidation, but technically it is not the same.

Joint ventures in company-only financial statements
As regards company-only financial statements that classify as 'separate financial statements', IAS 27 'Separate Financial Statements' provides that interests in joint ventures are measured at cost, fair value or according to the equity method.

According to Dutch accounting principles, net asset value should be applied in the company-only financial statements unless the entity uses Article 2:389(9) NCC to apply a different accounting principle, based on justified reasons to be disclosed in the explanatory notes.

35 Public-private concession contracts

35.1 Introduction

This chapter deals with the recognition of public-private concession contracts in the concessionaire's financial statements. In these, the concessionaire recognises the consideration it receives in exchange for building and/or improving an infrastructure as a financial asset or as an intangible asset. Recognition as a financial asset or as an intangible asset depends on the arrangements made between concessionaire and grantor.

A public-private concession contract means a contract between a concessionaire and a grantor under which the concessionaire provides a public service through an infrastructure after building or improving it. Under such a contract, the grantor (government) determines what services are to be provided with the infrastructure, to whom the services are to be provided and at what price (DAS 221.0). Infrastructure means (DAS 221.504):

a. the infrastructure built by the concessionaire for the performance of the concession contract or acquired from a third party; and
b. existing infrastructure to which the grantor provides access to the concessionaire for performance of the contract.

Examples of infrastructure include roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, and energy supply and telecommunication networks.

35.2 Scope of application

In the Dutch Accounting Standards, DAS 221.5 includes guidance to clarify the recognition of public-private concession contracts in the concessionaire's financial statements. This refers to recognition by the concessionaire in the following situations (DAS 221.502):

a. the grantor determines the services to be provided by the concessionaire using the infrastructure, to whom it provides them and at what price; and
b. the grantor acquires control of a significant residual interest in the infrastructure at the end of the contract or the infrastructure is entirely consumed during the contract.

DAS 221.5 does not apply to the recognition of a public-private concession contract in the financial statements of the grantor.

35.3 Recognition and measurement of considerations

In a public-private concession contract, infrastructure is built or improved on behalf of the government. As a result, as with construction contracts, there are project revenues and
costs. The concessionaire should recognise revenues and costs arising from the construction or improvement of infrastructure in accordance with the existing terms of DAS 221 'Construction Contracts'. Basically, this means that the revenues and costs of building or improving the infrastructure should be recognised and measured according to the 'percentage of completion' method as described in Chapter 12. The concessionaire recognises revenue and profit or loss during construction or improvement services because a consideration is received for the rendering of these services (DAS 221.507). Depending on the arrangements made between the concessionaire and the grantor, that transaction is accounted for as either:

- a financial asset; or
- an intangible asset.

The method of recognition to be applied depends on whether a financial or intangible asset is received in exchange for the construction or improvement services (DAS 221.507). The financial or intangible asset is recognised on the balance sheet under non-current or current assets. For the distinction between the two, see paragraph 2.11.

We expect concession contracts to mostly involve fixed assets. Concession contracts generally run for several years. Therefore, these assets will normally be intended to serve the exercise of the concessionaire's activity on a long-term basis (Article 2:364(1) NCC).

Any operating services to be provided under the concession contract are subject to the normal standards for rendering of services (DAS 221.517). See paragraph 26.6.2. While the revenues and costs of operating services result from a concession contract, they do not involve building or improving infrastructure.

35.4 Recognition and measurement of financial asset or intangible asset

The consideration for construction or improvement services to which the concessionaire is entitled must be recognised as a financial asset or as an intangible asset. To this end, the concessionaire must determine the nature of the consideration to be received based on the contract terms and relevant statutory provisions (DAS 221.506). In both alternatives, the initial measurement is at fair value. The distinction between financial asset and intangible asset is relevant for balance sheet and profit and loss account presentation.

Since the concessionaire only gains access to the grantor's infrastructure to operate it, there can be no tangible fixed asset on the concessionaire's balance sheet. This is because the concessionaire is not given control over the use of the infrastructure itself.

Financial asset
A financial asset exists if the grantor has the unconditional right to receive cash (or another financial asset) from the grantor (DAS 221.508). The terms of DAS 290 'Financial Instruments' apply to the financial asset. This means that the financial asset is measured at fair value on initial recognition and subsequently at amortised cost.

An unconditional right to receive cash (or another financial asset) is usually legally enforceable. This is the case when (DAS 221.508):

- there are specified or determinable amounts; or
- there is a right to receive any negative difference between the amounts received from public service users (see below under 'intangible asset') and the specified or determinable amounts.

This applies even if payment is conditional on the concessionaire ensuring that the infrastructure meets specified quality or efficiency requirements (DAS 221.508).

Example: Concession Contract (1) (extracted from Appendix 1 to DAS 221.5)

Company A entered into a contract with the government in which it was agreed that A would build a road within two years and then maintain the road for three years. After year 5, the contract expires. The government pays A 360 per year in years 3 to 5 for making the road available to the public.

In this example, A has the unconditional right to receive cash from the government. As a result, the consideration under the concession contract must be recognised as a financial asset.

Intangible asset
An intangible asset exists to the extent that the concessionaire has the right to charge service users. For example, the right to charge tolls. In this case, there is no unconditional right to receive cash (and therefore no financial asset) because the amounts receivable depend on the extent to which use is made of the service.

The terms of DAS 210 'Intangible fixed assets' apply to the intangible asset. This means that the intangible asset is initially measured at cost and then amortised over its economic life. For this purpose, cost is equal to the fair value of the expected consideration for the services provided.

Example: Concession Contract (2) (extracted from Appendix 1 to DAS 221.5)

Company A entered into a contract with the government in which it was agreed that A would build a road within two years and then maintain the road for three years. After year 5, the contract expires. In years 3 to 5, A has the right to charge road users a toll amount determined by the government.

In this example there is a consideration from the government to A in the form of the right to charge tolls. As a result, the consideration under the concession contract must be recognised as an intangible asset.

Example: Concession Contract (3)

Company B entered into a contract with the government in which it was agreed that B would build a water treatment plant and then be allowed to operate it at fixed rates. In principle, the contract runs for 40 years. However, if B has not achieved minimum guaranteed revenue in those 40 years, the contract will be extended for five-year periods at a time until the minimum guaranteed revenue is achieved.

In this example, there is no unconditional right to receive cash. The contract could theoretically be extended indefinitely without B managing to achieve the minimum guaranteed revenue. As a result, the consideration under the concession contract must be recognised as an intangible asset.

Does the answer change if the government guarantees to make up the shortfall in revenue if the minimum guaranteed revenue has not been achieved after 55 years?

Yes, in that case B has the unconditional right to receive cash. As a result, in that case, the consideration under the concession contract must be recognised as a financial asset.

Examples of recognising concession contracts
The examples below clarify how concession contracts are recognised in the concessionaire's financial statements. Firstly, we look at a situation where the concessionaire's consideration is classified as a financial asset. We then look at a situation where the concessionaire's consideration is classified as an intangible asset. The examples are taken from Appendix 1 to DAS 221.5 'Public-private concession contracts'.

These examples show that recognising the consideration receivable under the concession contract as an intangible asset or as a financial asset not only leads to a different balance sheet and profit and loss account presentation, but also to a different distribution of profits or losses over the life of the contract. Needless to say, over the entire life of the contract, the cumulative profit or loss under both recognition methods is the same.

Example: Recognition of a concession contract in the financial statements – financial asset

Company A entered into a concession contract with the government in which it was agreed that A should build a road within two years. Subsequently, A has to carry out road maintenance for a period of three years. At the end of year 5, A will have to put new asphalt on the road after which the contract will expire.

A will receive 360 in consideration in years 3-5 for making the road available to the public. The consideration under the concession contract should be recognised as a financial asset as A has the unconditional right to receive cash.

The restoration cost at the end of year 5 should be recognised as the cost of the service to be rendered under the concession contract. Indeed, the arrangements in the concession contract show that A receives a financial consideration in exchange for the restoration work to be carried out. As a result, there is no 'cost of restoration after use of the asset'.

The total contract costs for A can be itemised as follows:

	Construction costs	Operating costs	Restoration cost	Total
Year 1	400	-	-	400
Year 2	400	-	-	400
Year 3	-	20	-	20
Year 4	-	20	-	20
Year 5	-	20	40	60
Total	800	60	40	900

The fair value of the consideration receivable must be allocated to the various services A performs. A determined the fair value of the consideration receivable as follows:

	Road construction (cost + 5%)	Road maintenance (cost + 20%)	Road restoration (cost + 10%)	Total
Year 1	420	-	-	420
Year 2	420	-	-	420
Year 3	-	24	-	24
Year 4	-	24	-	24
Year 5	-	24	44	68
Total	840	72	44	956

In total, A receives a consideration of 1,080 (= 3 x 360). The difference between the nominal consideration receivable and the total fair value of the consideration receivable of 124 (= 1,080 - 956) is caused by the fact that the nominal consideration receivable also includes an interest component. This is because reimbursement is only received in years 3 to 5, while construction costs are already incurred in year 1 and year 2. Thus, the interest component is the resultant of the nominal consideration receivable and the total fair value of the consideration receivable.

The interest component relates only to the construction of the road. This is because the consideration for other rendering of services is received at the time the cost of rendering of services is incurred. The nominal consideration receivable is therefore allocated to these services based on the fair value of the individual deliverables as follows:

	Road construction (= a - b - c)	Road maintenance (b)	Road restoration (c)	Total (a)
Year 1	-	-	-	-
Year 2	-	-	-	-
Year 3	336	24	-	360
Year 4	336	24	-	360
Year 5	292	24	44	360
Total	964	72	44	1,080

A finances the costs to be incurred with an external loan and with retained profits from the project. The external financing is subject to 6% interest. Cash flows are assumed to occur at the end of each year. The loan balance can be determined as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening loan balance	-	-400	-824	-533	-225
Interest	-	-24	-49	-32	-14
Expenditures	-400	-400	-20	-20	-60
Repayment	-	-	360	360	299
Closing loan balance	-400	-824	-533	-225	-

The financial asset is initially measured at fair value and subsequently at amortised cost. For that, the effective interest rate is important. This can be determined using the cash flows (measured at fair value) associated with the construction of the road:

	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	-420	-420	336	336	292

The effective interest rate is the rate at which the total present value of these cash flows is zero. It follows that the effective interest rate is 5.8%.

Financial assets will be 420 at the end of the first year. This is the fair value of the consideration receivable allocated to costs incurred in year 1. In year 2, the financial asset accrues interest of 24 (= 5.8% x 420). In addition, the fair value of the consideration receivable allocated to costs incurred in year 2 is added to the financial asset. From year 3 onwards, an amount is received in addition to the accrued interest and the increase of the fair value of the consideration receivable allocated to the costs incurred. The movement of the financial asset over the life of the contract is as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening balance	-	420	864	578	276
Interest	-	24	50	34	16
Fair value of consideration receivable	420	420	-	-	-
Consideration received	-	-	-336	-336	-292
Closing balance	420	864	578	276	-

A recognises revenue and costs based on DAS 221 and DAS 270. This means that the cost of each service is recognised based on the progress of the services provided. Contract revenue (fair value of the consideration receivable) is recognised at the same time. The profit and loss account during the duration of the concession contract is as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Net revenue	420	420	24	24	68	956
Contract costs	-400	-400	-20	-20	-60	-900
Interest income	-	24	50	34	16	124
Interest expense	-	-24	-49	-32	-14	119
Net profit	20	20	5	6	10	61

Example: Recognition of a concession contract in the financial statements – intangible asset

Company A entered into a concession contract with the government in which it was agreed that A should build a road within two years. Subsequently, A has to maintain the road for a period of three years. At the end of year 5, A will have to put new asphalt on the road after which the contract will expire.

A has the right to charge tolls to road users in years 3 to 5. A expects the number of vehicles crossing the toll road to remain constant and this is expected to generate revenue of 360 per year. The consideration under the concession contract should be recognised as an intangible asset as A does not have the unconditional right to receive cash.

A provision must be recognised for the restoration cost at the end of year 5. Indeed, the arrangements in the concession contract show that A does not receive financial compensation for the restoration work. At the end of the life of the contract, A must restore the wear and tear on the road caused by its use during years 3 to 5. A should seek to cover the cost of restoration through toll revenues. Since the road is operated by A during years 3 to 5, the provision is also built up in these years. A measures the provision at present value. Assumed annual addition is 12.7, discounted at 4.9%. The structure of the provision is then as follows:

	Year 3	Year 4	Year 5
Opening balance	-	12.7	26.0
Interest accrual (4.9%)	-	0.6	1.3
Addition to provision	12.7	12.7	12.7
Closing balance	12.7	26.0	40.0

The progression of contract costs and the allocation of the consideration under the concession contract is the same as in the previous example.

A finances the costs to be incurred with an external loan and with retained profits from the project. The external financing is subject to 6% interest. The movement of the loan is also similar to the data included in the previous example.

A capitalises interest expense as part of the intangible asset during the period the road is under construction. From the moment the road is ready to be put into use, this is no longer allowed.

The intangible asset will be 420 at the end of the first year. This is the fair value of the consideration receivable allocated to costs incurred in year 1. The intangible asset is amortised over the life of the right to charge a toll (years 3 to 5). The movement of the intangible asset over the life of the contract is as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening balance	-	420	864	576	288
Interest	0	24	-	-	-
Fair value of consideration receivable	420	420	-	-	-
Amortisation	-	-	-288	-288	-288
Closing balance	420	864	576	288	-

A recognises revenue and costs based on DAS 221 and DAS 270. This means that the cost of each service is recognised based on the progress of the services provided. Contract revenue for construction work (fair value of consideration receivable) is recognised at the same time. In addition, toll revenue is recognised in years 3 to 5 when the road is used. The profit and loss account during the duration of the concession contract is as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Net revenue	420	420	360	360	360	1,920
Contract costs	-400	-400	-20	-20	-20	-860
Restoration cost	-	-	-13	-13	-13	-38
Amortisation costs	-	-	-288	-288	-288	-864
Interest expense (loan)	-	-	-49	-32	-14	-95
Interest expense (provision)	-	-	-	-1	-1	-2
Net profit or loss	20	20	-10	7	24	61

35.5 Other terms

Financial asset and intangible asset
The concessionaire may be paid for construction or improvement services partly through a financial asset and partly through an intangible asset. In that case, both components should be recognised separately and measured at fair value (DAS 221.515).

Allocation of consideration
A concession contract can include arrangements for both construction or improvement services and operating services. In such a case, the concessionaire should allocate the consideration to be received for operating the infrastructure based on the relative real values of the services provided, if such amounts are separately determinable. The nature of the consideration determines its further recognition (DAS 221.516).

Finance cost
Often, a concessionaire will take out a loan to finance the construction or improvement costs. The recognition of finance costs attributable to the concession contract depends on the classification of the consideration as a financial asset or an intangible asset. In the case of a financial asset, the concessionaire should recognise the financing costs attributable to the concession contract as expenses in the period in which they are incurred (DAS 221.510). When the consideration is recognised as an intangible asset, financing costs attributable to the concession contract may be capitalised during the construction phase of the contract (DAS 221.514). However, this is not mandatory under DAS 273. See also paragraph 27.2.

Restoration obligations
The concession contract may have imposed the following obligations on the concessionaire (DAS 221.520):

- the infrastructure must be maintained to a specified degree of usability; or
- the infrastructure must be restored to a specified condition before it is handed over to the grantor on termination of the contract.

The concessionaire must include a provision for restoration cost if the obligation to restore is due to the operation of the asset by the concessionaire. In that case, the concessionaire should seek to cover the cost of restoration from operating revenues (e.g. tolls). When the grantor does not operate the asset itself, but has to restore the asset to a certain condition on the instructions of the grantor in exchange for a financial consideration, this is a rendering of services. In that case, the associated costs and revenues are recognised in the profit and loss account in accordance with the terms of DAS 270. In all cases, based on the specific arrangements in the concession contract, it will have to be assessed whether a financial consideration will be received for the restoration obligations (and therefore it is a rendering of services), or whether the restoration obligations result from the concessionaire's operation of the asset (and therefore it is a provision for restoration cost).

If there is a provision for restoration cost, the terms of DAS 252 'Provisions, contingent assets and contingent liabilities' apply (DAS 221.520). The method of recognition of a provision for restoration cost is discussed in paragraph 7.2.3. This paragraph also addresses the moment at which a provision for restoration cost should be made. Indeed, that depends on whether the obligation already arises at the time an asset is put in place or only when the activities are carried out.

Funds provided by the grantor
In addition to financial or intangible assets, the grantor may provide the concessionaire with other assets that the concessionaire may hold or use as it sees fit. If such assets form part of the consideration payable by the grantor for the services, they are not government subsidies. These assets should be recognised on the concessionaire's balance sheet and measured at fair value on initial recognition. The concessionaire also recognises a liability from unfulfilled obligations it has entered into in exchange for the assets (DAS 221.519).

35.6 Disclosure

Under DAS 390, additional disclosures should be made if there is a rendering of services under concessions.

To the extent it is relevant to understanding whether, when and with what certainty cash can be generated, the concessionaire and the grantor should disclose the following in each period (DAS 390.102):

- an outline description of the arrangements;
- the key conditions in the arrangements that affect the size, timing and certainty of future cash flows;
- the nature and extent of:
    - the rights to use specific assets;
    - the obligations to render services or rights to expected rendering of services;
    - the obligations to purchase or construct tangible fixed assets;
    - the obligation to transfer specific assets at the end of the concession period or the rights to receive these assets;
    - renewal or termination options; and
    - other rights and obligations; and
- the changes in the arrangements during the period and how the concession contract is classified (as a financial asset or as an intangible asset).

The above disclosures should be made separately for each service concession arrangement or aggregated for each group of service concession arrangements (DAS 390.103). Thereby, a group is defined as a set of service concession arrangements where the services involved are of a similar nature (e.g. tolls, telecommunication services and water distribution).

The concessionaire should also disclose the revenue and profit or loss realised in the reporting period from the construction or improvement services provided in exchange for which a financial asset or an intangible asset has been recognised (DAS 390.102a). This effectively means that the revenue and profit or loss recognised in the profit and loss account for the financial year relating to those services from the concession contract must be disclosed.

35.7 Exemptions for medium-sized and small entities

No exemptions apply to medium-sized entities.

For small legal entities, the Dutch Accounting Standards for micro-sized and small entities refer to the Dutch Accounting Standards for medium-sized and large entities for the recognition and measurement of public-private concession contracts in the concessionaire's financial statements. Consequently, small entities have no exemptions for this.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

35.8 Significant differences from IFRS

Finance cost
If the consideration under a concession contract is recognised as an intangible asset, the financing costs during the construction phase must be capitalised in accordance with IAS 23 and IFRIC 12. It is therefore not permissible to recognise these financing costs as borrowing costs charged to profit or loss. NL GAAP does, however, allow this method of recognition.

Subsequent recognition
For the differences between the subsequent recognition of an intangible asset under DAS 210 and IAS 38, see paragraph 5.8. For the differences between the subsequent measurement of a financial asset under DAS 290 and IFRS 9, see paragraph 21.

36 Capita selecta: Cryptocurrencies and works of art

36.1 Cryptocurrencies

General
The Dutch Accounting Standards Board published a discussion paper in 2018 (DASB Statement 2018-7) with considerations on the method of recognition of cryptocurrencies in financial statements. Cryptocurrencies refer to a form of exchange of digital currencies. Cryptocurrencies are created with software. There are many types of cryptocurrencies that exist at different stages of maturity. Examples of well-known cryptocurrencies are: bitcoin, litecoins and ripple. A cryptocurrency is not linked to a physical currency and is not (currently) backed by any government, central bank, legal entity, underlying asset or commodity. Cryptocurrencies can be 'listed' on exchange platforms with the counter value being a currency (i.e. a price expressed in a currency such as, for example, the US dollar).

The discussion paper published by the Dutch Accounting Standards Board does not have the status of a draft or final standard. The discussion paper aims to provide a general debate on how cryptocurrencies can be classified and measured as an asset within Title 9 Book 2 NCC and the Dutch Accounting Standards. This relates to classification and measurement in cases where an entity has acquired cryptocurrencies by exchange or purchase. The discussion paper does not address the classification and measurement of cryptocurrencies issued by an entity (e.g. through a so-called Initial Coin Offering (ICO)) or cryptocurrencies that have been or are constructed by an entity through mining.

Several other national standard setters and the international standard setters are also doing analysis on how to recognise cryptocurrencies in financial statements. If specific developments therein give rise to a new view on recognising cryptocurrencies, the Dutch Accounting Standards Board will take them into account.

Not cash or financial asset
According to the Dutch Accounting Standards Board, cryptocurrencies do not meet the definition of cash or financial instrument (financial asset). This means they cannot be recognised as such in the financial statements. Cash is instruments in the form of paper or a coin (currency) or a balance at a bank (scriptural money). These funds are issued by a government or government-controlled institutions. However, cryptocurrencies are not issued or backed by a government, nor are they backed by a government-controlled institution. Consequently, cryptocurrencies are not cash, according to the Dutch Accounting Standards Board. Furthermore, ownership of cryptocurrencies does not involve a contractual right to receive cash or another financial asset from another party. As such, cryptocurrencies do not meet the definition of a financial instrument (financial asset) either.

Possible recognition methods
The possible recognition method depends on the objective of holding cryptocurrencies. For example, cryptocurrencies can be held for a longer term, for research projects, for sale in the normal course of business or as an investment.

Classification
Depending on the objective of holding cryptocurrencies, these can be classified as:

- intangible fixed assets;
- inventory; or
- other investments (than investments in financial instruments).

If cryptocurrencies are held for sale as part of ordinary operations, cryptocurrencies can be classified as inventory. This can be considered when cryptocurrencies are held as a means of exchange. Broker-dealers in cryptocurrencies whose aim is to earn a trade margin can also mark as-yet-unsold cryptocurrencies held by them as inventory.

If cryptocurrencies are held for use in the production or supply of goods or services or for administrative purposes in ordinary operations, cryptocurrencies may be classified as inventory or intangible fixed assets. In both situations, cryptocurrencies are not an investment, according to the Dutch Accounting Standards Board.

An investment can be defined as an asset held to realise income or appreciation, or both. An investment is not intended for use in the production or supply of goods or services or for administrative purposes in ordinary operations, or for sale as part of ordinary operations. If cryptocurrencies are held for this purpose, they are referred to as an (other) investment.

Recognition and measurement
Depending on the objective of holding cryptocurrencies, they are recognised and measured as follows:

- intangible fixed assets; intangible fixed assets are measured at purchase cost. Measurement at current value is allowed if the cryptocurrency has a frequent market quotation (see Chapter 5). When applying current value, changes in value are recognised directly in equity (via a revaluation reserve pursuant to Article 2:390 NCC);
- inventory; inventory is valued at the lower of cost or net selling price (see Chapter 11);
- other investments in accordance with Article 2:384 NCC; other investments may be measured at cost or current value. If measured at current value, changes in value may be recognised in the profit and loss account or initially through a revaluation reserve in equity and, on realisation, in the profit and loss account.

If applicable, the provisions regarding the distinction between fixed and current assets, impairments and the creation of a revaluation reserve are observed.

Cryptocurrencies considered as other investment
If cryptocurrencies are considered as other investment, the provisions of Title 9 Book 2 NCC apply. Article 2:384(7) NCC provides that increases in value of other investments measured at current value may be recognised immediately in the profit and loss account. If there is no frequent market quotation, a revaluation reserve is created pursuant to Article 2:390 (1) NCC, charged to the free reserves or from profit or loss of the financial year. No revaluation reserve is created if a frequent market quotation exists.

DAS 240.224 states that frequent market quotations exist if assets can be sold immediately at a quoted price in a liquid market. According to the Explanatory Memorandum to the Decree on current value (BAW), a liquid market exists if the assets in question are homogeneous, willing buyers and sellers can be found at any time and the transaction prices are publicly known. Whether there is a frequent market quotation will have to be assessed for each individual asset on the basis of all the facts and circumstances, given the diversity in forms of cryptocurrencies, as with other assets (such as financial instruments and agricultural inventory).

If cryptocurrencies are measured at current value as other investments pursuant to Article 2:384(1) NCC and value increases are not immediately recognised in the profit and loss account but are taken directly to equity, these value increases are included in a revaluation reserve pursuant to Article 2:390(1) NCC. Pursuant to Article 11 BAW, market value (fair value) qualifies as a proxy for current value. Under Article 2:384(1) NCC, cryptocurrencies classified as other investments can incidentally also be valued at cost. In that case, however, write-downs should be made if the market value is lower than cost.

Presentation
Article 9 of the Decree on annual accounts format (BMJ) states that when an amount could be included under more than one item, the notes should disclose under which other item(s) the amount could be included, the size of the amount and what it relates to. These disclosures must be made if it serves the insight referred to in Article 2:362(1) NCC. The BMJ does not stipulate how an other investment should be presented on the balance sheet. According to Article 7(2) BMJ, items may be inserted to the extent that the content is not covered by an item listed in the chosen format that is not designated as 'other'. This allows cryptocurrencies classified as other investments to be presented as a separate item on the balance sheet, complying with the provisions on the distinction between current and fixed assets. Given the nature of cryptocurrencies, presentation in a separate item is obvious (if material).

Notes
Based on Article 2:362(1) NCC, it is necessary to provide all the information necessary to form an opinion. Of course, the size of the item in respect of holding cryptocurrencies plays a role in the level of detail in the notes (materiality).

Pursuant to Article 2:384(5) NCC, the principles of measurement of assets and liabilities and determination of profit or loss must be set out in relation to each item (DAS 120.401). The entity may consider explaining the objective of holding cryptocurrencies and the considerations that played a role in the classification and measurement (also depending on materiality). According to the Dutch Accounting Standards Board, the entity should provide an explanation of the risks associated with cryptocurrencies and the business purposes served by them. Although cryptocurrencies are not financial instruments, a connection can be made with the disclosure provisions contained in DAS 290.9 (see paragraph 21.10.1).

36.2 Works of art

General
An entity may hold works of art for various reasons. Works of art refer to objects produced through art, such as paintings, sculptures and other works of art. The question is how an entity should recognise works of art it holds in its financial statements under Title 9 Book 2 NCC.

The basis for measuring an asset (including a work of art) is the purchase or manufacturing cost and the current value (Article 2:384(1) NCC). Article 2:384(1) NCC also provides that when choosing a basis for the measurement of an asset (including a work of art) and for the determination of profit or loss, the entity should be guided by the requirements of Article 2:362 paragraphs 1-4 NCC. Article 2:362(1) NCC provides that according to generally acceptable standards, the financial statements must provide such an insight that a responsible opinion can be formed on equity and profit or loss, and, as far as the nature of the financial statements allows, on the solvency and liquidity of the entity. Furthermore, it is relevant that Article 2:384(7) NCC provides, among other things, that in the case of measurement at current value, changes in the value of investments other than investments in financial instruments (investments in non-financial instruments) may be recognised immediately in profit or loss.

The Dutch Accounting Standards have no specific provisions for the recognition of works of art in the financial statements. If the Dutch Accounting Standards do not address a specific situation, the management board of an entity should choose a recognition method that provides relevant and reliable (in the meaning given by the 'Stramien' framework) information for the decision-making by the users of the financial statements (DAS 110.110). To obtain relevant and reliable information, we believe that an entity should take into account the reasons why works of art are held by an entity. In determining a relevant and reliable recognition method, an entity may also consider the existing standards applicable to assets that are similar in nature and reason for holding. There are a number of conceivable reasons why an entity may wish to hold works of art:

- investment purposes;
- decorative or museum purposes; and/or
- commercial purposes.

Works of art for investment purposes
If an entity holds works of art primarily to realise increases in value, the works of art held are classified as an investment. This is similar to property held as an investment. This does not exclude the possibility that the works of art held as investments also have decorative purposes. For example, if the artworks are hung in business premises. On initial recognition, works of art held as investments are measured at cost (including transaction costs). Investments can then be valued under Title 9 Book 2 NCC at cost (purchase or manufacturing cost) or current value.

When measurement is at cost, impairments must be taken into account (Article 2:384(1) NCC). Depreciation is only applicable under measurement at cost if a work of art has a finite useful life (in line with the measurement of investment properties at cost).

In the case of subsequent measurement at current value, the interpretation of the current value of a work of art held as an investment (pursuant to Article 11(1) BAW) concerns the market value. Market value is defined as the amount for which an asset can be traded between knowledgeable, willing parties in an arm's length transaction (Article 4 BAW). Pursuant to Article 2:384(7) NCC, changes in the value of works of art measured at market value can be recognised immediately in profit or loss. In that case, a revaluation reserve must be created under Article 2:390(1) NCC, as there are no frequent market quotations for works of art. Article 2:390(5) NCC requires that the notes explain whether and how, on revaluation, the impact of taxes on equity and profit or loss is taken into account. It can be inferred that Title 9 Book 2 NCC does not require the recognition of a deferred tax asset in relation to a revaluation. As a result, the Dutch Accounting Standards have not required the recognition of a deferred tax asset in respect of a revaluation. The Dutch Accounting Standards do, however, include a strong preference for recognition of a deferred tax asset (DAS 272.304). When a deferred tax asset is recognised, a positive difference between the carrying amount of an asset and its tax base results in a taxable temporary difference leading to a deferred tax liability.

Works of art for decorative or museum purposes
If an entity holds artworks primarily for decorative or museum purposes and therefore not primarily for investment purposes, the works of art held are classified as tangible fixed assets. This is similar to property held for own use,

because tangible fixed assets refer to tangible assets that are intended to support the entity's operations on a continuing basis (DAS 212.0). In this case, serving on a continuing basis as decoration of business premises or for educational and recreational purposes, respectively. A work of art that is classified as a tangible fixed asset should be measured at cost (including transaction costs) on initial recognition (DAS 212.301). After initial recognition, the work of art should be measured at (DAS 212.401):

- cost (purchase cost or manufacturing cost, as appropriate); or
- current value.

If a work of art is measured at current value, the interpretation of current value is current cost (Article 7 BAW). In the case of works of art that are not depreciated, we consider the market value plus current acquisition costs of a work of art to be the appropriate interpretation of current cost. Revaluations of works of art measured at current value are recognised directly in a revaluation reserve (Article 2:390(1) NCC). If the current value of an asset falls below its original cost, the write-down will be charged to the profit and loss account. Recognition of a deferred tax liability in conjunction with a revaluation is not required by law. However, the recognition of a deferred tax liability is strongly preferred (DAS 272.304).

Tangible fixed assets with a finite useful life should be depreciated separately (DAS 212.417). The question is whether a work of art has a finite useful life. Given the nature of many artworks, their useful life will often be infinite. In that case, depreciation on works of art is not appropriate. However, depreciation should take place on works of art for decorative purposes with a finite useful life.

If works of art are measured at current value with increases in value being recognised directly in a revaluation reserve, the recognition of the release of the revaluation reserve depends on the objectives in mind when applying current value. If the objective is merely to provide a more faithful representation of the value of works of art, the release of the revaluation reserve may be taken to the profit and loss account if such release is actually realised (for example when selling a work of art). In this way, the entire profit or loss realised on works of art sold is recognised in the profit and loss account. This is also known as nominalistic determination of the profit or loss. Alternatively, substantialistic determination of the profit or loss can be applied. In this case, the release of realised revaluations is not credited to the profit and loss account, but is recognised within equity.

Works of art for commercial purposes
Works of art can also be held for the purpose of sale in the ordinary course of business (DAS 220.105). This includes the buying and selling of artworks by an art dealer. In that case, the works of art held are classified as inventory of the art dealer. Such inventory must be measured at cost according to legal provisions. Measurement at current value is not allowed under Title 9 Book 2 NCC. Once a work of art held as inventory is sold, an entity recognises the proceeds from sale as revenue in the profit and loss account. The carrying amount of the artwork sold is recognised as an expense in the profit and loss account when the revenue is recognised.

An art dealer can also act as a sales agent for the owner of an artwork. If an art dealer acts as agent for the owner of a work of art that is sold, the art dealer only recognises as revenue the consideration the art dealer realises in exchange for acting as agent.

36.3 Exemptions for medium-sized and small entities

Medium-sized and small entities have no exemptions with regard to the recognition, measurement and presentation of cryptocurrencies and works of art.

Small entities need only include the information required by law in the notes and may consider disclosing additional information ('over and above the legal minimum') in the notes.

36.4 Significant differences from IFRS

Cryptocurrencies
Under IFRS, only recognition as intangible assets or recognition as inventory seems to qualify. IFRS does not have an 'other investments' category.

Broker-dealers in cryptocurrencies may, in accordance with IFRS (IAS 2 ‘Inventories’) value their inventory of cryptocurrencies at fair value less costs to sell, with changes in value recognised in profit or loss. Under the Dutch Accounting Standards, this is not allowed for inventory.

Works of art
IFRS, like the Dutch Accounting Standards, has no specific provisions for recognising works of art in the financial statements. Under IFRS, only recognition as tangible fixed asset (IAS 16 ‘Property, Plant, and Equipment’) or inventory (IAS 2 ‘Inventories’)) seems to qualify. This is because IFRS does not have an 'other investments' category. If the works of art held are held as investments and do not fall within the scope of IAS 16 or IAS 2, a method of recognition should be determined by an entity under IAS 8.10-12. In that case, we consider recognition by analogy with the recognition of investment property a possibility.

37 Interim reports

37.1 Introduction

General
The Dutch Accounting Standards Board defines an interim report as a financial report for a reporting period shorter than a full financial year (DAS 394.0). Examples include quarterly reports and half-yearly reports. So an interim report is not the periodic reporting to a company's management prepared solely for internal purposes. One can only speak of an interim report when the financial report is published and thus made available to a wider audience. Interim reports aim to provide users with timely information on current financial developments in a company. This chapter primarily addresses DAS 394 'Interim reports'.

Title 9 Book 2 NCC does not contain any provisions on the content of interim reports. However, Article 2:105 NCC does provide that a public limited liability entity that makes an interim distribution (interim dividend) must prepare an interim statement of assets and liabilities and file it with the Trade Register. DAS 394 does not apply to such an interim statement of assets and liabilities (DAS 394.202).

The Financial Supervision Act (Wet op het financieel toezicht, Wft) and the pertaining Decree implementing directive transparency of issuing institutions Wft (Besluit uitvoeringsrichtlijn transparantie uitgevende instellingen Wft) contain a number of provisions on interim reports of listed companies. These are not addressed in this manual (see paragraph 1.1.1 on PIEs).

Dutch Accounting Standards
In DAS 394, the Dutch Accounting Standards Board has included provisions relating to the content of an interim report. These apply to entities that state that an interim report has been prepared in accordance with the Dutch Accounting Standards (DAS 394.101). DAS 394.301 also indicates that entities do not need to include more information in an interim report than is required to be included in the financial statements or management board report under other chapters of the Dutch Accounting Standards. If the entity's most recent financial statements include consolidated financial statements, it will be sufficient for the interim report to include information on a consolidated basis. The Dutch Accounting Standards Board recommends publishing an interim report within three months of the end of the period to which the report relates (DAS 394.203).

37.2 Form and content of interim reports

37.2.1 Abridged statements

According to the Dutch Accounting Standards Board, an interim report consists of at least (DAS 394.301):

- an abridged balance sheet;
- an abridged profit and loss account;
- an abridged equity movement schedule;
- an abridged cash flow statement; and
- specific notes to the above statements.

It also stipulates that the abridged statements in the interim report should include at least the sections that are also included in the most recently published financial statements (DAS 394.302).

Balance sheet
For the balance sheet, sections mean the line items set out in the Decree on annual accounts format (*Besluit modellen jaarrekening*, BMJ) which are represented by Roman numerals (DAS 115.214). For the asset side of the balance sheet, these include intangible fixed assets, tangible fixed assets, financial fixed assets, inventory, receivables, securities and cash. For the liabilities side of the balance sheet, these include the distinguished items of equity, provisions, non-current debt and current debt.

Profit and loss account
For the profit and loss account, sections are formed by series of line items in the models of the Decree on annual accounts format, which are not interrupted by subtotals (DAS 115.215). In the presentation by nature of expense of the profit and loss account, these are the sum of operating income, the sum of operating expenses, profit or loss

before tax and profit or loss after tax. In the presentation by function of the profit and loss account, this includes gross margin, net margin, profit or loss before tax and profit or loss after tax.

Cash flow statement
For the cash flow statement, the Dutch Accounting Standards Board does not specify what should be understood by sections. It may be assumed that an abridged cash flow statement will at least include cash flow from operational activities, cash flow from investment activities and cash flow from financing activities.

Equity movement schedule
For the equity movement schedule, too, the Dutch Accounting Standards do not elaborate on the term section in this context. It is obvious to assume that all significant changes in equity are disclosed separately.

37.2.2 Comparative figures

The various components of an interim report must include comparative figures (DAS 394.306):

- an abridged balance sheet at the end of the interim period with a balance sheet at the end of the last completed financial year as a comparative figure;
- the abridged profit and loss accounts for the relevant interim period and cumulatively for the current financial year, using as comparative figures the profit and loss accounts for the same interim period and cumulative period in the previous financial year;
- an abridged statement of changes in equity from the beginning of the financial year to the end of the interim period, using as comparative figures the statement of all changes in equity in the same period in the previous financial year; and
- an abridged cash flow statement showing the cash flows for the period from the beginning of the financial year to the end of the interim period, using as comparative figures the cash flow statement for the same period in the previous financial year.

Example: Half-yearly report

A company presenting a half-yearly report for the first half of year T includes the following parts in this half-yearly report:

	Interim period Year T	Comparative figures Year T-1
Balance sheet as at	30 June	31 December
Profit and loss account for	1 January to 30 June	1 January to 30 June
Equity movement schedule for	1 January to 30 June	1 January to 30 June
Cash flow statement for	1 January to 30 June	1 January to 30 June

Example: Quarterly report

A company presenting a quarterly report for the first quarter of year T includes the following parts in this quarterly report:

	Interim period Year T	Comparative figures Year T-1
Balance sheet as at	31 March	31 December
Profit and loss account for	1 January to 31 March	1 January to 31 March
Equity movement schedule for	1 January to 31 March	1 January to 31 March
Cash flow statement for	1 January to 31 March	1 January to 31 March

This company includes the following parts in its quarterly report for the second quarter of year T:

	Interim period Year T	Comparative figures Year T-1
Balance sheet as at	30 June	31 December
Profit and loss account for	1 April to 30 June	1 April to 30 June
Profit and loss account for	1 January to 30 June	1 January to 30 June
Equity movement schedule for	1 January to 30 June	1 January to 30 June
Cash flow statement for	1 January to 30 June	1 January to 30 June

In the quarterly report for the third quarter of year T, this company includes the following parts:

	Interim period Year T	Comparative figures Year T-1
Balance sheet as at	30 September	31 December
Profit and loss account for	1 July to 30 Sept.	1 July to 30 Sept.
Profit and loss account for	1 January to 30 Sept.	1 January to 30 Sept.
Equity movement schedule for	1 January to 30 Sept.	1 January to 30 Sept.
Cash flow statement for	1 January to 30 Sept.	1 January to 30 Sept.

In case of highly seasonal activities, it is recommended to provide additional data for a 12-month period ending at the end of the interim period being reported on, using as comparative figures the same data for the previous comparable 12-month period (DAS 394.306).

Example: Quarterly report in case of highly seasonal activities

If the company of the previous example has highly seasonal activities, the quarterly report for the third quarter of year T would include the following sections, for example:

	Interim period Year T	Comparative figures Year T-1
Balance sheet as at	30 September	31 December
Profit and loss account for	1 July to 30 Sept.	1 July to 30 Sept.
Profit and loss account for	1 January to 30 Sept.	1 January to 30 Sept.
Profit and loss account for	1 October T-1 to 30 Sept.	1 October T-2 to 30 Sept.*
Equity movement schedule for	1 January to 30 Sept.	1 January to 30 Sept.
Equity movement schedule for	1 October T-1 to 30 Sept.	1 October T-2 to 30 Sept.*
Cash flow statement for	1 January to 30 Sept.	1 January to 30 Sept.
Cash flow statement for	1 October T-1 to 30 Sept.	1 October T-2 to 30 Sept.*

* It is not clear from DAS 394.306 which additional statements for a 12-month period with accompanying comparative figures should be provided in the case of highly seasonal activities. As it talks about 'data', we assume that not only a profit and loss account has to be provided, but also an equity movement schedule and cash flow statement for the 12-month period including related comparative figures.

37.2.3 Management board notes and key ratios

In addition to the mandatory inclusion of abridged statements with accompanying comparative figures, the Dutch Accounting Standards Board recommends the inclusion of management board notes and a summary of key figures in the interim report. It is recommended that these management board notes include information about the expected course of events for the current financial year, also in view of the expectations in this respect expressed in the last management board report (DAS 394.305).

37.2.4 Earnings per share

If the entity applies DAS 340 'Earnings per share' in the financial statements (see paragraph 30.4), the interim report must disclose basic and diluted earnings per share (DAS 394.301).

37.2.5 Additional information

An entity that publishes an interim report is free to provide more extensive disclosures than described above (DAS 394.301). Additional information should be included if omission would result in the interim report not providing a proper insight (DAS 394.302).

37.3 Notes to interim reports

At least the following information must be disclosed in the notes to the interim report, provided the information is material to understanding the interim report (DAS 394.303):

- the statement that the same accounting principles are used for the measurement of assets and liabilities and determination of profits and losses as in the financial statements, or, if these principles have been changed, a description of the nature of the change and its impact on equity and profit or loss;
- an explanation of the seasonal or cyclical nature of the reported activities;
- an explanation of the nature and extent of exceptional items (by nature, size or frequency of occurrence), including relevant changes to previously reported accounting estimates, affecting assets, liabilities, equity, net profit or cash flows;
- the issuance, repurchase, and redemption of debt instruments and equity instruments;
- dividends paid (in total or per share) separately for the different types of shares;
- the revenues and profit or loss of business segments or geographical segments, depending on the primary segmentation basis. This information is required only to the extent that segment information is provided in the financial statements;
- Subsequent events after the date of the end of the interim period with significant financial consequences for the entity and the companies included in its consolidated financial statements taken together, to the extent not recognised in the interim report;
- the effects of changes in group structure during the interim period, including mergers, acquisitions and disposals of group companies and participating interests, long-term investments, reorganisations and activities being terminated;
- changes in contingent liabilities or receivables since the reporting date of the last financial statements;
- the fact that the interim report has not been audited by an external auditor. If an external auditor did issue an opinion to the interim report, it should be included in full in the interim report. This will usually be a review report.

In addition, the notes to interim reports should include information on significant events that have occurred with regard to discontinued operations since the last financial statements (DAS 345.405). This information includes significant changes in amounts or the timing of settlement.

All explanatory information should be provided cumulatively for the current year. Both the notes and the recognition, measurement and presentation of items in the interim report should take into account the relative significance in relation to the financial data included in the interim report (DAS 394.307). Events or transactions that are material to understanding the current interim period should be disclosed (DAS 394.303). This may result in disclosures that need not be relevant to the financial statements.

37.4 Recognition and measurement of items in interim reports

37.4.1 Introduction

When preparing an interim report, the same basis for measurement and determination of profit or loss must be applied as in the financial statements (DAS 394.401). The same recognition criteria therefore apply to the recognition of assets, liabilities, revenues and costs in the interim report as to the recognition of these items in the financial statements.

37.4.2 Allocation of income and expenses

Seasonal, cyclical or incidental income should not be anticipated in an interim report (DAS 394.402). Nor should such income be deferred if such recognition would also not be acceptable at the end of a financial year (DAS 394.402). Income should therefore be recognised in the interim period in which they are realised. This means, for example, that a gain on the sale of a tangible fixed asset should be recognised in the interim period in which the sale was realised.

A similar provision applies to costs: costs that do not occur over time should be anticipated in an interim report, or deferred only if such recognition would also be acceptable at the end of a financial year (DAS 394.403). This means, for example, that a provision should not be recognised in the interim report until the conditions for creating a provision in the financial statements are met. It also means that only costs that meet the conditions for capitalisation in the financial statements are capitalised.

Example: Cost allocation (1)

A company issues a quarterly report every quarter. This company presents new models of products in the first quarter of each financial year that will be sold throughout the year. At that point, many costs are incurred for a major advertising campaign targeting sales for the whole year.

In this situation, all advertising costs are charged to the first quarter. Advertising costs may not be spread over the four quarters, as advertising costs may also not be capitalised in the financial statements.

This also means that fixed costs may not be allocated taking into account the seasonal pattern (DAS 394.403).

Example: Cost allocation (2)

A manufacturer of school furniture has highly seasonal revenues. The breakdown of revenue by quarter is as follows: 15% in the first quarter, 15% in the second quarter, 50% in the third quarter and 20% in the fourth quarter. School furniture is manufactured more evenly throughout the year. This company has many fixed costs, including fixed costs related to the manufacturing process and fixed selling costs.

In periods when little revenue is generated, a relatively large amount of fixed costs are charged directly to profit or loss. Only fixed manufacturing costs capitalised in school furniture inventory are charged to profit or loss as cost of sales in the periods in which the sales are realised. Fixed selling costs should be charged to profit or loss in the period in which they are incurred. Selling costs should also not be included in the valuation of inventory in the financial statements.

Example: Revenue allocation

A participation entity receives dividends from its participating interests almost exclusively during the first half of the year. Costs are incurred throughout the year.

Based on the requirements in DAS 394, the participation entity must recognise dividends received in the first half of the year in full as revenue while costs relating to the first half of the year must be recognised as expenses. In the second half of the year, dividends to be recognised as revenue will be close to nil, while costs will continue. As a result, profits for the first half of the year will be (relatively) high, while losses for the second half of the year may even have to be recognised.

37.4.3 Tax expense

Tax expense in the interim report should be determined based on the effective tax rate expected for the relevant financial year (DAS 394.401). This is because the tax payable is determined on the basis of the fiscal profit or loss for the entire financial year.

Example: Allocation of tax expense (1)

A company issues a quarterly report every quarter. The expected quarterly pre-tax profit for this company is as follows:

	Expected profit
1st quarter	50
2nd quarter	90
3rd quarter	(40)
4th quarter	100
Total	200

The tax rate for the relevant financial year is 25 for the first 100 and 35 for profits above 100.

The expected taxable profit for this financial year is: 200 (= 50 + 90 -/- 40 + 100).

The expected tax expense for this financial year is: 60 (= 25% x 100 + 35% x 100).

The expected effective tax rate for this financial year is therefore 30.

If budgeted profit is equal to realised profit, this leads to the following preparation of the profit and loss account:

	1st quarter	2nd quarter	3rd quarter	4th quarter	Financial year
Profit before tax	50	90	(40)	100	200
Tax expense or income	(15)	(27)	12	(30)	(60)
Profit after tax	35	63	(28)	70	140
Tax burden	30%	30%	30%	30%	30%

Example: Allocation of tax expense (2)

The company of the previous example now has the following expectations regarding its quarterly profit before tax:

	Expected profit
1st quarter	50
2nd quarter	50
3rd quarter	(40)
4th quarter	(100)
Total	(40)

In the situation where there are no carry back opportunities and the company does not recognise a deferred tax asset, the expected tax expense for this financial year is 0 and therefore the expected effective tax rate is also zero.

For the four quarters, this leads to the following preparation of the profit and loss account:

	1st quarter	2nd quarter	3rd quarter	4th quarter	Financial year
Profit before tax	50	50	(40)	(100)	(40)
Tax expense or income	0	0	0	0	0
Profit after tax	50	50	(40)	(100)	(40)

37.4.4 Accounting estimates

The method of measurement in an interim report should ensure that the information provided in the interim report is reliable and that all material financial information relevant to a good understanding the entity's financial position or profit or loss achieved is set out (DAS 394.404).

However, it is known from practice that more accounting estimates are made when preparing an interim report than when preparing financial statements (DAS 394.307). Of course, it is possible to prepare an interim report with the same accuracy as financial statements, but it will come at a higher cost. The reason that lower accuracy is considered generally acceptable is the fact that financial statements are given more importance by the public.

The frequency of reporting (annual, half-yearly or quarterly) should not affect the annual determination of profit or loss. The entire period between the last prepared financial statements and the reporting date of the interim report should be considered when measuring and determining profit or loss in the context of the preparation of interim reports. This may result in accounting estimates recognised in earlier interim reports being revised in a later interim report for the same year (DAS 394.401).

If the revision of an accounting estimate incorporated in an interim report is made in the financial statements, because no separate interim report is prepared after the interim report, the nature and amount of the change in the accounting estimate are disclosed in the notes (DAS 394.308).

37.4.5 Changes in accounting policies

As indicated above, the same basis for measurement and determination of profit or loss should be applied in the preparation of interim reports as in the financial statements. Of course, it is possible to make a change in accounting policies, which will also be recognised in the next financial statements. In that case, the provisions applicable to changes in accounting policies in the financial statements should be applied mutatis mutandis to interim reports (DAS 394.405).

Changes in accounting policies are recommended to be made in the first interim period reported (DAS 394.405). Obviously, the decision to do so must have been made then. If a change in accounting policies is implemented in a period other than the first interim period of the financial year, the figures for the previous interim periods of the same year should be amended on the basis of the new accounting policies. The figures added for comparison from the comparable interim period in the previous year should also be adjusted.

37.5 Exemptions for medium-sized and small entities

When applying DAS 394 (voluntarily), medium-sized entities can use the statutory exemptions from the presentation and publication provisions for medium-sized entities (DAS 394.103). Moreover, medium-sized entities do not need to include more information in an interim report than is required to be included in the financial statements or management board report under other chapters of the Dutch Accounting Standards (DAS 394.103).

For small entities, there are no requirements in laws and regulations for preparing an interim report. This is different only if an entity has issued securities listed on a regulated market (stock exchange). In that case, the legal requirements of the Financial Supervision Act apply; see paragraph 1.12 for a more detailed discussion of interim reporting by listed companies.

37.6 Significant differences from IFRS

Impairments
IFRIC 10 'Interim Financial Reporting and Impairment' states that an impairment of goodwill recognised in a prior interim report should not be reversed. The Dutch Accounting Standards do not contain such a provision.

38 Financial statements of small entities prepared based on tax accounting principles

38.1 Introduction

General
Small entities can apply tax measurement principles in the financial statements prepared for commercial purposes. This is regulated by Article 2:396(6) NCC and the Decree on tax measurement principles (*Besluit fiscale waarderingsgrondslagen* or BFW). Article 2:396(6) NCC reads that notwithstanding Section 6 of title 9 Book 2 DCC, for the measurement of the assets and liabilities and for the determination of the profit or loss, the accounting principles for the determination of the taxable profit (fiscale winst) referred to in chapter II of the Corporate Income Tax Act 1969 (*Wet op de vennootschapsbelasting 1969*) (Vpb Act 1969) may also be applied. If a small entity applies these accounting principles, this is disclosed in the notes. Article 2:396(6) NCC also states that detailed rules on the use of these accounting principles and the notes thereto may be laid down by Order in council (AMvB). These detailed rules are contained in the BFW.

Tax accounting principles are the principles for the measurement of assets and liabilities and the determination of taxable profit (fiscale winst) referred to in Chapter II of the 1969 Corporate Income Tax Act. Commercial accounting principles are the principles for the measurement of assets and liabilities and the determination of the profit or loss, referred to in Section 6 of Title 9 Book 2 NCC.

The Dutch Accounting Standards Board has included in the Dutch Accounting Standards for micro-sized and small entities the 'Guide to the application of tax accounting principles by small entities' (DASsmall D3.2). The purpose of this practical guide is to assist small entities in preparing their financial statements based on tax accounting principles. The guide discusses some peculiarities in the application, by a small entity, of tax accounting principles in financial statements. The guide does not address the content or further interpretation of the tax accounting principles themselves. For this, please refer to tax laws and regulations and tax case law.

The starting point of this guide is to avoid, as far as possible, differences between the financial statements prepared using tax accounting principles and the corporate income tax returns. The aim is for the balance sheet and profit and loss account according to these financial statements and according to this return to be as similar as possible. Due to tax regulations (such as investment deductions, limited deductible expenses and loss set-off), a full reconciliation with the taxable amount is not possible. The starting point of the guide is that the profit and loss account of the financial statements prepared using tax accounting principles should reflect taxable profit calculation (fiscale winst) (rather than taxable profit (belastbare winst) or taxable amount (belastbaar bedrag)) as far as possible. However, in the profit and loss account of the financial statements prepared using tax accounting principles, the corporate income tax payable for the financial year must be deducted from the profit (or added to the amount of the corporate income tax receivable).

The taxable profit calculation (fiscale winst) is the profit based on tax measurement principles, before corrections under tax regulations, as evidenced by the corporate income tax return. The taxable profit (belastbare winst) is the taxable profit calculation (fiscale winst) after corrections under tax regulations, but before reduction due to losses to be offset. The taxable amount (belastbaar bedrag) is the taxable profit (belastbare winst) earned in a year reduced by losses to be offset (DASsmall D3.2.102).

Equity reconciliation
In the corporate income tax return, the taxable profit calculation is primarily derived from an equity reconciliation. Consequently, the method of recognition (through profit or loss or directly in equity) does not in principle affect the taxable amount. For this reason, different recognition methods may occur in practice, which may also depend on the tax return software used. Therefore, in line with its nature, the guide does not contain mandatory requirements regarding recognition in financial statements, but only sets out possible recognition methods.

The taxable profit calculation (fiscale winst), taxable profit (belastbare winst) and taxable amount (belastbaar bedrag) obtained from the equity reconciliation and the relationship between them can be illustrated as follows:

Example: Relationship between equity reconciliation, taxable profit, and taxable amount (extracted from appendix to DASsmall D3.2)

Company A BV, a private limited liability entity, has the following statement of the taxable amount of 100,000 in its corporate income tax return. 19,000 corporate income tax is due on that taxable amount.

The calculation of the taxable profit and taxable amount from the equity reconciliation in the corporate income tax return is as follows:

Company equity at the end of the financial year	220,000
Company equity at the beginning of the financial year	100,000
Difference in equity	120,000
Dividend distribution	46,000
Corporate income tax	19,000
Balance of taxable profit (calculation)	185,000
Adjustments from:	
Exempt profit components	(30,000)
Non-deductible or partially deductible expenses	5,000
Investment deduction	(10,000)
Change in permissible reserves (additions to reinvestment reserve and cost equalisation reserve)	(35,000)
Taxable profit (belastbare winst)	115,000
Losses to be offset	15,000
Taxable amount (belastbaar bedrag)	100,000

The taxable profit and the taxable amount according to the equity reconciliation are ultimately equal to the taxable profit and the taxable amount as calculated from the profit and loss account. The calculation of the taxable amount from the taxable profit calculation and its relationship with the profit and loss account in the financial statements prepared using tax accounting principles is as follows:

	Tax return	Financial statements
Revenues	400,000	400,000
Costs	250,000	250,000
Taxable profit calculation (fiscale winst)	150,000	
Profit or loss before tax		150,000
Adjustments from:		
Exempt profit components	(30,000)	
Non-deductible or partially deductible expenses	5,000	
Investment deduction	(10,000)	
Taxable profit (belastbare winst)	115,000	
Losses to be offset	15,000	
Taxable amount (belastbaar bedrag)	100,000	
Corporate income tax		(19,000)
Profit or loss after tax		131,000

Micro-sized entities

Micro-sized entities can also apply tax measurement principles in the financial statements prepared for commercial purposes. This is regulated by Article 2:395a(7) NCC and the Decree on tax measurement principles (BFW). The financial statements of micro-sized entities are dealt with in Chapter 39. The chapter also addresses the financial statements of micro-sized entities prepared using tax accounting principles. The Dutch Accounting Standards Board has issued a separate 'Guide to the application of tax accounting principles by micro-sized entities' (DASsmall D3.1) for micro-sized entities.

38.2 Background to the option to use tax accounting principles

General

The purpose of Article 2:396(6) NCC is to reduce the administrative burden for small entities. This is in line with the Dutch government's efforts to reduce the administrative burden on SMEs. The government felt that this could largely be achieved by enabling financial data to be submitted using XBRL. According to the Explanatory Memorandum to the draft bill to allow tax accounting principles, the ultimate aim was to 'arrive at a combined document, with which the entrepreneur can fulfil both an important part of its filing obligation under Title 9 Book 2 NCC and its obligation to declare under the Vpb Act 1969'. The question is whether the goal of reducing the burden has been achieved. After all, there would only be a real reduction in burden if a small entity could make do with (one-off) electronic filing of one single document, combining the financial statements prepared for both tax and commercial purposes. However, that is not the case, and a small entity still has to file a balance sheet and notes with the Trade Register and also file corporate income tax returns.

Legal option

Small entities are not required to make use of tax accounting principles in their financial statements. This option concerns only the application of tax measurement principles in the financial statements. Other legal provisions, such as those relating to the preparation, adoption and publication of the financial statements, remain unchanged.

Also, all applicable presentation and disclosure requirements of Title 9 Book 2 NCC continue to apply. Article 2:396(6) NCC implies that the commercial principles for measurement and determination of profit and loss of Section 6 of Title 9 Book 2 NCC are not applied. Therefore, all other requirements of Section 6 and also those of Title 9 Book 2 NCC other than Section 6 do actually apply to financial statements based on tax accounting principles (DASsmall D3.2.107). These include the provisions on the presentation of the balance sheet and profit and loss account (including application of the BMJ) and the provisions on the disclosure and the creation of legal reserves. Paragraph 38.5 discusses in more detail the presentation and disclosure requirements in financial statements prepared using tax accounting principles.

The starting point of this chapter is that a small entity uses the consolidation exemption for small groups of Article 2:407(2) NCC. For the situation where a small entity does prepare consolidated financial statements, please refer to paragraphs 403 to 405 of the 'Guide to the application of tax accounting principles by small entities'.

38.3 Scope

An entity may prepare its financial statements according to its tax accounting principles if it meets the size criteria of Article 2:396(1) NCC (DASsmall D3.2.104) based on those tax accounting principles and/or based on its commercial accounting principles (for two consecutive years). Of course, use can then also be made of the other exemptions and facilities applicable to small entities. Medium-sized and large entities cannot benefit from this option. For size criteria and their general application, please refer to paragraph 1.5.

It is noteworthy that the determination of the size criteria may be made based on either tax accounting principles or commercial accounting principles. This means that an entity that qualifies as small based on its tax accounting principles but as medium-sized or large based on its commercial accounting principles may prepare its financial statements based on its tax accounting principles. The reverse is also true. An entity that qualifies as medium-sized or large based on its tax accounting principles, but small based on its commercial accounting principles, may prepare its financial statements based on its tax accounting principles. The systematics of Article 2:396 NCC do not seem to allow the latter. However, the Explanatory Memorandum states that 'entities have the choice of calculating the transition from medium-sized to small or from small to medium-sized based on either commercial or tax figures'.

Example: Application of size criteria (1)

Entity A qualifies as a small entity based on the value of its assets (balance sheet total) under commercial accounting principles and based on the number of employees and prepares its financial statements and publication documents applying the facilities applicable to small entities. Net revenue exceeds the revenue criterion applicable to small entities. A significant part of A's assets consists of property leased to third parties. Since the WOZ (Valuation of Immovable Property Act) value is higher than the (tax) carrying amount, depreciation on these properties is no longer applied, according to tax accounting principles. For this reason, A's balance sheet total based on tax accounting principles is higher than it is based on commercial accounting principles. Based on tax accounting principles, both the balance sheet total and net revenue exceed the criteria applicable to small entities. Because A qualifies as a small entity based on its commercial accounting principles, it may prepare its financial statements based on its tax accounting principles. And incidentally, it may also present its financial statements and publication documents applying the facilities applicable to small entities, despite the fact that it would qualify as a medium-sized entity based on those tax accounting principles.

If an entity qualifies as small based on its tax accounting principles and/or based on its commercial accounting principles for both the financial year and the previous financial year, it can immediately avail itself of the exemptions and facilities applicable to small entities. This entity is classified as a small entity and can base its financial statements on tax accounting principles.

Example: Application of size criteria (2)

Entity A qualifies as a medium-sized entity based on commercial accounting principles. To date, A has always prepared and published its financial statements in accordance with the requirements for medium-sized entities. Due to (voluntary) tax depreciation rules, application of reinvestment reserves and measurement of participating interests at cost, the value of assets based on its tax accounting principles is lower than that based on commercial accounting principles. Since A qualifies as a small entity based on its tax accounting principles for both the financial year and the previous financial year, it is allowed to prepare its financial statements based on its tax accounting principles with immediate effect, and, for that matter, also prepare its financial statements and publication documents applying the facilities applicable to small entities.

The determination of whether or not the criteria set out in Article 2:396(1) NCC are met must be considered based on consolidated figures, pursuant to paragraph 2 of that article. If the determination is carried out based on figures according to tax accounting principles, the tax accounting principles of the consolidating entity must be applied. If necessary, the financial data of companies to be included in the consolidation are recalculated for this purpose.

An entity that heads a small group can usually avail itself of the exemption from preparing consolidated financial statements for small groups (Article 2:407(2) NCC). In the situation where a small entity does prepare consolidated financial statements, the consolidation scope may differ from that of the fiscal unity, for example because foreign entities are also part of the group and included in the consolidated financial statements. The fact is, the fiscal unity can only include Dutch entities. Moreover, there is no obligation to include all eligible Dutch entities in the fiscal unity. There may also be non-100% participating interests that cannot be included in the fiscal unity but are part of the consolidation scope.

Public interest entities as referred to in Article 2:398(7) NCC (including listed companies, banks and insurance companies, see paragraph 1.1.1), pension funds (Article 146 of the Pension Act) as well as investment entities as referred to in Article 2:398(3) NCC are excluded from the possibility of preparing financial statements based on tax accounting principles.

38.4 Recognition and measurement

No cherry picking
So-called 'cherry picking', i.e. applying tax measurement principles to only a few financial statement items, is not allowed. Article 2:396(6) NCC speaks of all tax principles applicable to it. The choice in favour of tax accounting principles should cover all balance sheet and profit and loss account items applicable to this entity.

Depreciation
Depreciation may be restricted for tax purposes, meaning that no depreciation is charged to taxable profit. For example, for property, depreciation is allowed until the fiscal base value is reached. This is also adopted in financial statements prepared using tax accounting principles (DASsmall D3.2.201a).

Measurement of participating interests
Participating interests not being part of the fiscal unity
If the participating interest is not part of the fiscal unity, the measurement basis for the financial statements prepared using tax accounting principles is the same as the measurement basis applied in the corporate income tax return. This means that if the participating interest is measured in the corporate income tax return at, for example, 'cost or lower value in use', that is also the measurement basis for the financial statements prepared using tax accounting principles (DASsmall D3.2.202). This also means that if the participating interest is measured at 'net asset value' or 'visible equity' in the corporate income tax return, this measurement basis is also applied in the financial statements prepared using tax accounting principles. After all, the tax measurement basis is then 'net asset value' or 'visible equity'. This will often be possible for participating interests covered by the participation exemption. The corporate income tax return will then include a profit or loss from the participating interest, but this will then be excluded from the taxable amount through the participation exemption.

Participating interests being part of the fiscal unity
If the participating interest belongs to the fiscal unity for corporate income tax purposes of the small entity, the participating interest may be valued at the net amount of its assets and liabilities, measured according to the tax measurement principles. As a result, in principle, the equity will match the tax equity according to the return. If the 'net asset value for tax purposes' is negative, this amount is recognised as a liability, regardless of whether there is an obligation to make up this shortfall. The upshot is that even in that situation, equity will in principle match tax equity. This liability item can be presented, for example, as 'provision for participating interests' (DASsmall D3.2.202).

If goodwill arising from the acquisition of shares is recognised in equity in the tax return, the goodwill is recognised in the financial statements in the same manner (DASsmall D3.2.202).

Construction contracts
For tax purposes, intermediate recognition of profit has been made mandatory for construction contracts. This is also adopted in the financial statements prepared using tax accounting principles (DASsmall D3.2.202a).

Taxes
Corporate income tax payable or receivable for the financial year is recognised on the balance sheet and in the profit and loss account of the financial statements based on tax accounting principles and presented separately. This is regulated by Article 2(2)(b) BFW. This is in contrast to the corporate income tax return, in which this item is obviously not included in the profit and loss account. After all, that return is intended precisely for calculating corporate income tax based on the taxable profit and other tax facilities.

Deferred taxes are not recognised in financial statements based on tax accounting principles (DASsmall D3.2.204). After all, there are no measurement differences of assets and liabilities that could lead to a deferred tax asset or liability on the balance sheet. Furthermore, when tax accounting principles are applied, no deferred tax assets are recognised in respect of loss carry-forward.

Gains and reinvestment reserves
Gains on disposal of an asset – if no reinvestment reserve for tax purposes is created – are credited to the profit and loss account, as part of, for example, other operating income or net revenue (in the case of regularly recurring sales of tangible fixed assets in the course of normal business activities). However, if the choice is made to create a reinvestment reserve for tax purposes (if the conditions are met), the amount of the gain is recognised as a direct equity movement in the reinvestment reserve. These gains are therefore not part of the taxable profit and are therefore also not credited to the profit and loss account in the financial statements prepared using tax accounting principles (DASsmall D3.2.205). Reinvestment reserves belong to equity. Reinvestment reserves are included separately in equity in the financial statements prepared using tax accounting principles (Article 2(1) BFW).

If replacement of the asset takes place, these reserved gains are deducted directly from the replacement investments to the extent acceptable for tax purposes (DASsmall D3.2.205). If a reinvestment reserve is not utilised or only partially utilised and is released to taxable profit under tax accounting principles at any time, this release is still recognised in the profit and loss account (DASsmall D3.2.206).

Major maintenance
For major maintenance, a cost equalisation reserve can be created (to evenly distribute costs and charges), or a provision formed (if the requirements of the so-called 'Baksteenarrest' are met), for tax purposes. In financial statements based on tax accounting principles, the entity must apply the method it uses in its corporate income tax return.

Provision for major maintenance
If a provision for major maintenance is formed for tax purposes, additions to and withdrawals from this provision are recognised in accordance with the recognition under commercial accounting principles (DASsmall D3.2.207). See paragraph 7.2.2.

Cost equalisation reserve
A cost equalisation reserve for tax purposes is an item that forms part of equity. The accumulation of the cost equalisation reserve is charged to the profit and loss account as part of other operating expenses, for example. If major maintenance is subsequently carried out in any year, the cost of the major maintenance carried out is charged

to the cost equalisation reserve (DASsmall D3.2.207). If the actual costs incurred exceed the balance of the cost equalisation reserve, the additional costs are recognised in the profit and loss account. If the actual costs incurred are lower than the reserve created in the cost equalisation reserve for that purpose, the remainder of the reserve is released to the profit and loss account. The reserve is also released to the profit and loss account if the purpose for which it was created has lapsed (DASsmall D3.2.207).

Informal capital
This exists, for example, if the entity buys business premises from a shareholder at a price lower than the fair value. In that case, the property is normally measured at fair value for tax purposes at initial valuation. This measurement basis is then also applied in the financial statements prepared using tax measurement principles. The difference between fair value and transaction price represents informal capital. Informal capital is presented under share premium (DASsmall D3.2.406).

Hidden dividend
This exists, for example, when goods are sold to the shareholder at less than fair value. For tax purposes, fair value is considered the selling price. Therefore, a gain is recognised that is equal to the fair value less the carrying amount of the asset. The hidden dividend is then charged to free reserves at the same value as a dividend distribution. The outstanding corporate income tax and any dividend tax are recognised as a liability (DASsmall D3.2.407).

Recognition of tax adjustments
The Tax Administration may proceed to post-tax recovery of tax for previous years, for example as a result of an audit. In principle, this leads to an adjustment of taxable profit and corporate income tax payable or receivable for those earlier years. In effect, an adjustment is made to the corporate income tax return(s) for previous years. However, these adjustments can no longer be made in the financial statements already adopted for these earlier years. To maintain reconciliation with the tax return, it is possible to retrospectively recognise adjustments for previous years (including the adjustment to corporate income tax payable or receivable) in the financial statements based on tax accounting principles (DASsmall D3.2.401). That is, recognition in the opening equity of the oldest unadopted financial statements. Such adjustments should be disclosed (Article 2:363(5) NCC).

For the sake of reconciliation with the tax treatment of adjustments, the recognition of tax adjustments on this point deviates from Chapter A3.3 of the Dutch Accounting Standards for micro-sized and small entities (DASsmall D3.2.402). The processing of tax adjustments in the financial statements follows the tax treatment. This means that if a correction in the tax return leads to an adjustment of the taxable profit for the previous fiscal year, the tax correction in the financial statements of the current fiscal year is retrospectively processed in the comparative figures, regardless of the size of the correction. The adjustment of the comparative figures does not constitute a modification of the financial statements of the previous fiscal year. If a tax correction in the tax return leads to an adjustment of the taxable profit for the current fiscal year, then the tax correction in the financial statements of the current fiscal year is prospectively processed, regardless of the size of the correction.

In practice, the corporate income tax return will often be prepared at a later time than the financial statements. The figures recognised in the return may then differ from those recognised in the financial statements. For example, because they are influenced by subsequent events or by estimates. The resulting adjustments can be recognised in the same way as the tax corrections described above.

38.5 Presentation and disclosure

General
For financial statements based on tax accounting principles, all presentation and disclosure requirements of Title 9 of Book 2 NCC apply. This concerns, for example, the presentation of the balance sheet and profit and loss account, as contained in Sections 3 and 4 of Title 9 and the Decree on annual accounts format (BMJ). And also the disclosures required under Section 5 of Title 9. Some specific, additional presentation and disclosure requirements are also included in the BFW. These additional requirements are addressed in this paragraph.

Balance sheet before or after appropriation of profit or loss
In financial statements based on tax accounting principles, the balance sheet can be prepared before or after appropriation of profit or loss (DASsmall D3.2.302). At the top of the balance sheet there will be an indication of whether it includes the appropriation of profit or loss (Article 2:362(2) NCC).

Equity
On the balance sheet, tax reinvestment reserves are shown separately under equity (Article 2(1) BFW). A reinvestment reserve is not a legal reserve under Title 9 Book 2 NCC. Combined with the requirements of Article 2:373(1) NCC the following items are recognised separately when tax accounting principles are applied (DASsmall D3.2.303):

- the issued capital;
- share premium;
- legal reserves;
- statutory reserves;
- reinvestment reserves; and
- other reserves.

Consideration could be given to including a movement schedule for these items. This provides insight into direct equity movements and movements recognised through the profit and loss account and/or by virtue of profit or loss appropriation (DASsmall D3.2.303).

Tax allowable reserves other than the reinvestment reserve may be presented in the financial statements under Other reserves. Alternatively, these reserves may be presented under a separate item 'Other tax reserves' as part of equity. This includes the cost equalisation reserve (DASsmall D3.2.304).

If a participating interest is measured at net asset value and that participating interest holds a reinvestment reserve, consideration may be given to also recognising a reinvestment reserve (e.g. reinvestment reserve for participating interest) in the participating entity. This, according to the Dutch Accounting Standards Board, provides insight into the nature of the item and the fact that it has not yet been subject to taxation (DASsmall D3.2.304a).

Legal reserves may appear in financial statements based on tax accounting principles. Indeed, the rules on legal reserves cannot be considered as principles for the measurement of assets and liabilities and the determination of profit or loss. If participating interests are measured other than at cost or lower value in use, for example at net asset value, a legal reserve may be necessary under Article 2:389(6) NCC, such as the legal reserve for participating interests (DASsmall D3.2.306). For legal reserves, see paragraphs 14.3.7 and 14.3.8.

Disclosure of accounting principles applied and measurement deviations
If the entity applies the tax accounting principles applicable to it, it must disclose this in the notes (Article 2:396(6) NCC). In addition, the separate accounting principles for the measurement of assets and liabilities and for the determination of the profit or loss should be disclosed (Article 2:384(5) NCC) (DASsmall D3.2.308).

The notes should disclose the items for which the use of tax measurement principles leads to a deviation from the commercial measurement that is important for the understanding of equity. These are therefore material deviations. However, the information need not be quantified. The objective of this information is only to make users of the financial statements aware of the effect of applying tax accounting principles to the items in question. These notes must also be included in the annual accounts to be published pursuant to Article 2:394 NCC (Article 3(1) BFW) (DASsmall D3.2.309). Consideration could be given to whether the deviation has an upward or downward effect for each item.

For example, an explanatory text might read as follows:

'The use of tax measurement principles means that participating interests and machinery and equipment are valued lower than they would be if valued on a commercial basis. In contrast, land and buildings are valued higher.'

38.6 Transition to tax measurement principles and change of tax measurement rules

Transition to/from tax measurement principles: change in accounting policies
The transition from commercial accounting principles to tax measurement principles is a change in accounting policies to which Article 2:384(6) NCC applies. There must be a justified reason for a change in accounting policies, which should be explained in the notes. A justified reason for this change in accounting policy on the grounds of first-time

application of tax measurement principles may be the realisation of a reduction in administrative burden (DASsmall D3.2.501).

It follows from Article 1 BFW that the cumulative effect of the change in accounting policy is recognised in equity at the beginning of the financial year in which the tax measurement principles are applied for the first time. Contrary to the normal rules for changes in accounting policies, only the total effect on equity needs to be disclosed. In addition, the comparative figures do not need to be adjusted. In this case, comparative figures are recognised based on commercial measurement principles. Incidentally, Article 2:363(5) NCC does allow comparative figures to be adjusted, provided this is disclosed (DASsmall D3.2.502).

The transition from tax measurement principles to commercial measurement principles is a change in accounting policies to which Article 2:384(6) NCC applies in full (DASsmall D3.2.503). Such a change in accounting policy is recognised retrospectively, including adjustment of the comparative figures. See paragraph 3.1.

38.7 Position of shareholders

Impact on distributability of equity
In accordance with Article 2:216(1) NCC, a (dividend) distribution to shareholders is only possible to the extent that a private limited liability entity's equity exceeds its legal and statutory reserves. In addition, it follows from Article 2:216(2) NCC that distributions are only allowed insofar as the continuity of the company is guaranteed. Applying tax measurement principles does not change these legal requirements. Since tax measurement of assets will generally be lower than commercial measurement, applying tax measurement principles will generally lower equity. However, this does not necessarily mean that distributable equity will also be lower. Indeed, if there are no legal or statutory reserves, the distributability of the equity is determined solely by the distribution test. In that case, the distributability of the equity does not play a role in deciding whether or not to use tax measurement principles in the financial statements. If there are legal or statutory reserves, however, it is advisable to include this aspect.

It may also be that the application of tax measurement principles increases equity. For example, through the measurement of the liability for the director-major shareholder's pension arrangements that are held in-house. When market interest rates are low, a provision under tax accounting principles will be able to be significantly lower than the actual pension liability (under 'commercial' accounting principles). However, this does not increase the distributable equity. This is because the distribution test should then be based on the actual pension liability according to 'commercial' accounting principles.

Position of minority shareholders
The decision that an entity will apply tax measurement principles will primarily be taken by the management board of the entity. The management board is responsible for preparing the financial statements. Subsequently, the majority of shareholders represented in the general meeting will agree (implicitly or not) to the use of tax accounting principles by adopting these financial statements. Minority shareholders who object to the application of tax measurement principles will not be able to enforce different measurement principles in the general meeting.

38.8 Significant differences from IFRS

Tax accounting principles
Small entities (including micro-sized entities) can apply tax measurement principles under NL GAAP in the financial statements prepared for commercial purposes. Under IFRS, the application of tax measurement principles is not allowed.

39 Financial statements of micro-sized entities

39.1 Introduction

Micro-sized entities have far-reaching exemptions for presentation and publication their financial statements. Micro-sized entities are only required to prepare an abridged balance sheet and profit and loss account and therefore no notes. A micro-sized entity is only required to provide specific disclosures in a few situations (see paragraph 39.5). Micro-sized entities need only publish an abridged balance sheet (see paragraph 39.7). The purpose of adding the category of micro-sized entities is administrative burdens reduction.

39.2 Scope

An entity is classified as a micro-sized entity if it meets two or three of the following requirements on two consecutive reporting dates (Article 2:395a(1) NCC):

- value of assets ≤ EUR 350,000;
- net revenue ≤ EUR 700,000; and
- number of employees < 10.

The limits for the asset value and net revenue criteria will be adjusted in 2024, possibly as early as financial years beginning on or after 1 January 2023. Refer to paragraph 1.5.

For the application of these criteria, the value of the assets, the net revenue and the number of employees of group entities that would have to be included in the consolidation if the entity had to prepare consolidated financial statements are taken into account. This does not apply if the entity applies the exemption of Article 2:408 NCC (Article 2:395a(2) NCC). If a personal holding entity is not the head of a group, it has no consolidation obligation (see paragraph 33.2.2). In that case, too, the determination of whether the personal holding entity qualifies as a micro-sized entity takes place on a non-consolidated basis. For a more detailed description of how to determine these criteria, see paragraph 1.5.

The general meeting may decide, no later than six months after the beginning of the financial year, not to apply the exemptions for micro-sized entities (Article 2:398(2) NCC). Investment entities, participation companies and public-interest entities (see paragraph 1.1.1) are not allowed to use the exemptions for micro-sized entities (Article 2:398(3), (6) and (7) NCC). A micro-sized entity may apply the group exemption of Article 2:403 NCC, provided it meets all the conditions (see paragraph 1.7).

39.3 Recognition and measurement

General
Micro-sized entities are subject to the 'normal' accounting principles of Title 9 Book 2 NCC as they must (or may be) also be applied by small entities. See Chapters 1 to 38 of this manual. There are two exceptions to this:

- micro-sized entities may choose not to recognise prepayments and accrued income or accruals and deferred income for other operating expenses (Article 2:395a(3) NCC); and
- micro-sized entities are not allowed to measure assets and liabilities at market value (fair value) (Article 5a Decree on current value (BAW)).

Prepayments and accrued income and accruals and deferred income
The law provides that micro-sized entities need not recognise prepayments and accrued income or accruals and deferred income for other operating expenses (Article 2:395a(3) NCC). For example, no prepayments and accrued income for prepaid rent. From a tax perspective, this is not allowed. If an entity chooses to not recognise prepayments and accrued income or accruals and deferred income, differences with the measurement for tax purposes will often arise. Deferred taxes must be recognised for these differences (see Chapter 17). However, prepayments and accrued income or accruals and deferred income should be recognised for items other than other operating expenses. For example, rental or other income received in advance or interest payable.

No measurement at market value (fair value)
The Decree on current value (BAW) states that measurement at market value is not allowed for micro-sized entities (Article 5a BAW). This means that if an entity measures investment property or financial instruments at market value, it cannot use the exemptions for micro-sized entities. Not even if the entity does meet the size criteria of Article 2:395a(1) NCC. In that case, such entities may use the exemptions for small entities.

Incidentally, micro-sized entities are allowed to measure certain assets at current value as long as that is not market value. These are tangible and intangible fixed assets, other than investments, and agricultural inventories. In that case, tangible and intangible fixed assets are measured, not at market value, but at the current cost or lower recoverable amount. Agricultural inventories are measured at net selling price (DASsmall M1.302). See Chapters 5, 7 and 11.

The measurement of a provision for self-administered pension schemes for directors-major shareholders based on an actuarial measurement method generally accepted in the Netherlands is not a measurement at market value. Similarly, impairment of items to a lower market value when applying the measurement basis of historical cost does not qualify as measurement at market value (DASsmall M1.303).

Tax accounting principles
Like small entities, micro-sized entities may also apply tax valuation principles in their (commercial) financial statements. This is provided for in Article 2:395a(7) NCC and the Decree on tax valuation principles (BFW). See paragraph 38.4 for how to apply tax valuation principles.

First-time application of regime for micro-sized entities
When an entity applies the regime for micro-sized entities of Article 2:395a NCC for the first time, there will be a change in accounting policies. In many cases, although the measurement principles will not change, the presentation on the balance sheet will. That, too, constitutes a change in accounting policies. A change in accounting policies as a result of applying the regime for micro-sized entities of Article 2:395a NCC for the first time must be recognised retrospectively (including adjustment of the comparative figures) in accordance with the description in paragraph 3.1. A micro-sized entity does not have to explain a change in accounting policies (DASsmall M1.304). Of course, there is no change in accounting policies if a newly incorporated entity applies the regime for micro-sized entities in its first financial statements.

39.4 Presentation

The financial statements of a micro-sized entity are limited to an abridged balance sheet and profit and loss account with comparative figures for the previous financial year. The Decree on annual accounts format (BMJ) does not apply to micro-sized entities (Article 1(3) BMJ).

Balance sheet
In the balance sheet, where applicable, the following items are included (Article 2:395a(4) NCC):

Balance sheet	Year t	Year t-1		Year t	Year t-1
Fixed assets	000.000	000.000	Equity	000.000	000.000
Current assets	000.000	000.000	Provisions	000.000	000.000
			Non-current debt	000.000	000.000
			Current debt	000.000	000.000
Total	000.000	000.000	Total	000.000	000.000

If costs associated with the establishment and the issue of shares have been capitalised (see paragraph 5.2), they are recognised separately under fixed assets. Under current assets, issued capital called but not paid up is recognised separately (Article 2:395a(4) NCC).

By the letter of the law, non-current and current debts do not have to be presented separately. According to the legal text, the amounts of current debt and non-current debt are indicated for the total debts (Article 2:395a(4) NCC). This condition is met in case of a separate presentation.

Legal reserves and capital protection
Legal reserves must be recognised but do not have to be presented separately on the balance sheet. Micro-sized entities are subject to the same capital protection rules as other entities. See paragraph 14.2.

Profit and loss account
In the profit and loss account, where applicable, the following items are recognised separately (Article 2:395a(5) NCC):

Profit and loss account	Year t	Year t-1
Net revenue	000.000	000.000
Other operating income	000.000	000.000
Cost of raw materials and consumables	(000.000)	(000.000)
Depreciations and impairment losses	(000.000)	(000.000)
Wages	(000.000)	(000.000)
Other operating expenses	(000.000)	(000.000)
Taxes	(000.000)	(000.000)
Profit or loss after tax	000.000	000.000

39.5 Disclosure

In principle, a micro-sized entity only has to provide the following information in the notes:

- if the micro-sized entity prepares the financial statements based tax accounting principles, it discloses this in the notes (Article 2:395a(7) NCC);
- for public limited liability entities only: any acquisition and disposal for its own account of its own shares and share certificates. The company discloses the reasons for the acquisition as well as the number, nominal amount and agreed price of the shares and share certificates and the proportion of capital they represent (Article 2:395a(4) NCC). This disclosure is included at the bottom of the balance sheet;
- the micro-sized entity discloses at the top of the balance sheet whether it includes the appropriation of profit or loss (Article 2:362(2) NCC);
- if applicable, the micro-sized entity discloses at the bottom of the balance sheet that no prepayments and accrued income or accruals and deferred income relating to other operating expenses have been recognised (Article 2:395a(3) NCC); and
- the micro-sized entity that uses the consolidation exemption for intermediate holding entities of Article 2:408 NCC (see paragraph 33.3.2) must disclose its application in the notes (Article 2:408(3) NCC).

According to the Dutch Accounting Standards Board, however, exceptional circumstances may arise that result in the micro-sized entity's financial statements, without additional information, led to a serious deficiency in the view to be provided as referred to in Article 2:362(1) NCC. In such circumstances, Article 2:362(4) NCC requires the micro-sized entity to provide information in the financial statements in addition to the requirements in Article 2:395a NCC for the micro-sized entity (DASsmall M1.202). As examples, the Dutch Accounting Standards Board mentions the application of liquidation principles and the occurrence of serious uncertainty about going concern. A micro-sized entity is of course free to voluntarily include more information in the financial statements than required by Article 2:395a NCC.

39.6 Other exemptions

Micro-sized entities are exempt from preparing a management board report and the Other information. A micro-sized entity is also exempt from the legal audit requirement (Article 2:395a(6) NCC).

39.7 Publication requirement

A micro-sized entity only needs to publish the abridged balance sheet as described in paragraph 39.4. Moreover, a public limited liability entity must also include the disclosures referred to in paragraph 39.5 regarding the acquisition and disposal of its own shares. The other disclosures listed in paragraph 39.5 need not be published. The abridged balance sheet must be published in the manner and within the time limits set out in Article 2:394 NCC. See paragraph 1.6. If a micro-sized entity voluntarily includes more information in the prepared financial statements than required by Article 2:395a NCC, the entity nevertheless only has to publish the abridged balance sheet (DASsmall M1.402).

39.8 Significant differences from IFRS

Exemptions based on size
Micro-sized entities have far-reaching exemptions under NL GAAP for preparing and publishing their financial statements. IFRS has no exemptions based on an entity's size.

40 Commercial foundations and associations

40.1 Application of Title 9 Book 2 NCC

40.1.1 General

An association is an entity with members that is dedicated to a particular purpose. That purpose must not be to meet certain material needs of its members by entering into agreements with those members in the business operated for the members' benefit. If that were indeed the case, it would be a cooperative. An association is not allowed to distribute profits among its members (Article 2:26 NCC).

A foundation is an entity without members, which aims to achieve a purpose stated in its articles of association with the help of appropriated equity for that purpose. This purpose may not include making distributions to founders or to those who form part of its bodies. Nor may this purpose include making distributions to others unless such distributions have a non-commercial or social purpose (Article 2:285 NCC).

Foundations and associations are normally not-for-profit organisations (see Chapter 41). Despite the absence of a profit motive, a foundation or association may engage in the provision of products and/or services, e.g. a world shop (wereldwinkel), a museum shop or a foundation providing (non-subsidised) education or engaged in childcare. If certain conditions are met, such foundations and associations are referred to as commercial foundations and associations.

Commercial foundations and associations are those foundations or associations that meet the conditions of Article 2:360(3) NCC (DAS 630.0):

- the foundation or association maintains one or more businesses that must be registered in the Trade Register pursuant to the law; and
- the net revenue of these businesses for two consecutive financial years without interruption amounts to half or more of the threshold of EUR 12 million referred to in Article 2:396(1)(b) NCC. The limit for whether or not Title 9 Book 2 NCC applies is therefore EUR 6 million. The threshold will be adjusted in 2024, possibly as of financial years commencing on or after 1 January 2023. See paragraph 1.5. Throughout the rest of this chapter, the amount of EUR 6 million is consistently assumed.

Commercial foundations and associations must apply the provisions of Title 9 Book 2 NCC for their annual accounts. Title 9 Book 2 NCC does not apply to foundations and associations that are required by or pursuant to law to prepare financial statements equivalent to financial statements that are prepared on the basis of Title 9 Book 2 NCC and published (DAS 630.101).

The following paragraphs explain the above criteria in more detail.

40.1.2 Maintaining one or more businesses

The first criterion reads 'maintaining one or more businesses that must be registered in the Trade Register pursuant to the law'. Whether they are also actually registered is not relevant (DAS 630.102). The legislative history shows that these are foundations and associations that, with a business, participate commercially in society and can therefore generally be counted as businesses. They operate in the market and compete with other companies.

Trade Register Decree
Guidance on the presence of a business is contained in the Trade Register Decree 2008 and the Policy rule 'Het ondernemingsbegrip in het Handelsregister' ('The term business in the Trade Register') (DAS 630.102). According to Article 2(1) of the Trade Register Decree 2008, a business exists 'if there is a sufficiently autonomous organisational unit of one or more persons, in which, through a sufficient contribution of labour or resources, services or goods are provided or works are created for the benefit of third parties with the aim of achieving a material benefit'.

The Policy rule 'The term business in the Trade Register', dated 17 May 2011, shows that in assessing whether there is a business, the criteria used by the Tax Administration to assess whether there is a business within the meaning of the Value Added Tax (VAT) Act should be followed. These criteria are:

- goods and/or services are provided;
- a more than token fee is charged for this;
- there is participation in (normal) economic activity;
- there is an organisation of labour and capital;
- there is regular participation in economic activity (sustainable participation);
- there is more than one client/customer (self-employment); and
- the freedom exists to carry out the work as they see fit.

If the definition from the Trade Register Decree 2008 and the aforementioned criteria from the Policy rule 'The term business in the Trade Register' are met, a business exists. If a foundation or association qualifies as an entrepreneur within the meaning of the Value Added Tax Act, but the foundation or association has no intention of deriving material benefit from the activities in question, it is not a business. In assessing whether there is such an intention, the purpose of the profit is irrelevant and existing case law is partly guiding. That case law shows a broad interpretation of the term business. It should be remembered that the absence of aiming profit does not mean that no material benefit is intended. A foundation or association may also have certain activities with the intention of gaining material benefit from them. For example, to generate funds that can be used for the social objective of a foundation or association. Incidental professional or business dealings may also qualify as running a business. The policy rule cites the one-off commercial organisation of a pop festival as an example.

Relationship with corporate income tax liability
Typically, commercial foundations and associations will be liable for corporate income tax, at least if and to the extent that they are running a business. Non-commercial foundations and associations may also have (limited) liability for corporate income tax. According to case law, the term business under the Corporate Income Tax Act is somewhat broader than the term business under the Trade Register Decree 2008. Businesses within the meaning of the Trade Register Decree 2008 will therefore also be businesses for corporate income tax purposes, but it will not always be the case the other way round.

Business maintained by a group entity
Businesses maintained by group entities of the foundation or association are not included in the assessment of whether the foundation or association maintains a business (DAS 630.103).

A foundation or association can house commercial activities in a separate entity, such as a private limited liability entity. The shares of that private limited liability entity are then held by the foundation or association. In this structure, the foundation or association is not subject to Title 9 Book 2 NCC. After all, in that case, the business is not maintained by the foundation or association, but by the private limited liability entity. Of course, the private limited liability entity itself does fall within the scope of Title 9 Book 2 NCC.

Example: Qualifying as a commercial foundation or association

Foundation A holds 100% of the shares of BV A, a private limited liability entity. BV A maintains a business that must be registered in the Trade Register. BV A's net revenue is EUR 10 million. Foundation A has no other commercial activities. Does Title 9 Book 2 NCC apply to foundation A?

No. The business is maintained by BV A and not by foundation A. Only the net revenue from business activities of foundation A itself is counted. See also the paragraph below. The figures of the business are included in the financial statements filed by BV A with the Trade Register.

40.1.3 Net revenue

The term net revenue
The definition of net revenue is contained in Article 2:377(6) NCC and reads: 'net revenue is defined as the revenue from the goods supplied and services rendered by the entity's business after deduction of discounts etc., and taxes

levied on revenue' (such as turnover tax). The term net revenue should be interpreted from the perspective of the ordinary, recurring operating activities (DAS 270.201). See also paragraph 26.8.

The aforementioned also implies that grant income and contributions or donations received without any consideration being provided in the form of products and/or services in return, are not part of net revenue. Therefore, if grants and other contributions are not directly related to the supply of goods and/or services to the lender, they are not considered net revenue. In our opinion, if goods or services are provided to the lender as a customer on a commercial basis, there will be net revenue. Of course, it is important to consider the specific circumstances (including the grant conditions) when deciding whether grants and other contributions should be included in net revenue.

Net revenue on a company-only basis
In assessing whether there is a commercial foundation or association, it is only the net revenue of the business(es) maintained by the foundation or association that matters and therefore not the net revenue of the foundation or association as a whole (DAS 630.106). Also, according to the legislative history, the net revenue of group entities to be consolidated does not count when assessing whether there is a commercial foundation or association. This is therefore just about the foundation or association's company-only net revenue from its business activities (DAS 630.103).

Example: Qualifying as a commercial foundation or association

Foundation A has two separate activities, namely childcare and welfare activities for the elderly. The childcare business has been incorporated into BV A, a private limited liability entity, 100% of whose shares are held by foundation A. BV A is consolidated by foundation A. BV A's net revenue is around EUR 5 million a year. Welfare activities are carried out directly by Foundation A and include maintaining a meeting centre for the elderly. For the welfare activities, foundation A receives an operating grant from the municipality of about EUR 34 million a year. In addition, foundation A has income from the catering facility at the meeting centre of about EUR 0.5 million a year. Does Title 9 Book 2 NCC apply to foundation A?

No. The net revenue from the business activities of foundation A amounts to EUR 0.5 million and thus remains below the limit of EUR 6 million. The net revenue from the business activities of BV A and the operating grant of foundation A is irrelevant.

If a foundation or association maintains several businesses and there are transactions between those businesses, the transactions between them must be eliminated for calculating net revenue.

Net revenue for two consecutive financial years
Title 9 Book 2 NCC applies if the net revenue from the business(es) is EUR 6 million or more for two consecutive financial years without interruption. Once Title 9 Book 2 NCC applies, the application only lapses if the EUR 6 million limit has not been reached for two consecutive years without interruption (DAS 315.105).

The law does not contain rules for cases where a financial year is longer or shorter than 12 months. For classification by size, it is recommended that net revenue as a criterion for determining the applicable category be calculated proportionately over 12 months. In the case of a long financial year, it is also permissible to use the net revenue of the last 12 months as a criterion (DAS 315.103). In our view, such an approach can also be applied when assessing compliance with the EUR 6 million limit. See also paragraph 1.5.

Article 2:398(1) NCC stipulates how the size criteria for the first and second financial year should be applied. It is recommended that this article be applied analogously to the size criterion of Article 2:360(3) NCC. This means that Title 9 Book 2 NCC also applies to the financial statements for the first and second financial year of a newly established foundation or association which maintains one or more business(es) which must be registered in the Trade Register and that has met the relevant net revenue criterion during the first financial year (DAS 630.105).

Application of size criteria
The limit of EUR 6 million net revenue determines when a foundation or association with commercial activities is sufficiently large to have to comply with Title 9 Book 2 NCC. Only when this is indeed the case, the question arises whether it is a small, medium-sized or large foundation or association (see paragraph 1.5 above). Pursuant to Article 2:398(5) NCC, the size criteria for the 'value of assets' criterion must take into account the foundation or association

as a whole, while the 'net revenue' and 'average number of employees' criteria are only assessed on the basis of the business(es) maintained by the foundation or association itself (DAS 630.401).

40.1.4 Publication of equivalent financial statements

Title 9 Book 2 NCC does not apply to a commercial foundation or association that is required by or pursuant to law to prepare financial statements equivalent to financial statements prepared on the basis of Title 9 Book 2 NCC and also published these financial statements. This often involves specific legislation applicable to certain categories of institutions, such as hospitals, educational institutions, housing associations and pension funds. According to the Explanatory Memorandum, equivalence implies that the information provided as a whole and in terms of level and nature is in line with the requirements of Title 9 Book 2 NCC. Publishing in this context does not solely include filing with the Trade Register (DAS 630.107). If the annual accounts are kept available to any interested party according to the relevant rules, this will suffice.

40.2 Annual reporting in general

40.2.1 Introduction

Paragraph 2 of this chapter provides a general consideration of the laws and regulations applicable to commercial foundations and associations. Paragraph 3 then addresses specific aspects of the annual reporting of commercial foundations and associations.

40.2.2 General accounting and record-keeping obligation

Article 2:10 NCC contains the general record-keeping obligation. This obligation applies to all entities to which Book 2 NCC applies, including commercial foundations and associations. This article prescribes that the management board is obliged to keep such records of the foundation's or association's financial position that the foundation's or association's rights and obligations can be known at any time. Furthermore, the management board is obliged to keep the accounts and the balance sheet and statement of income and expenses for seven years (Article 2:10(1) and (3) NCC). The management board is obliged to prepare the balance sheet and statement of income and expenses of the foundation or association annually within six months of the end of the financial year (Article 2:10(2) NCC).

40.2.3 Title 9 Book 2 NCC and the Dutch Accounting Standards

Paragraph 40.1 has already discussed the fact that commercial foundations and associations are fully subject to Title 9 Book 2 NCC. Title 9 Book 2 NCC contains some articles specifically applicable to commercial foundations and associations:

- commercial foundations and associations must disclose in the notes both the regulations according to the articles of association regarding the appropriation of profit or loss and the appropriation of profit or loss in the financial year (Article 2:383a NCC and Article 2:392(5) NCC). They therefore do not mention the regulations regarding the appropriation of profit or loss under the Other information; and
- the size criteria are based on the assets of the foundation or association and the net revenue and average number of employees of the business(es) it maintains (Article 2:398(5) NCC).

The Dutch Accounting Standards for medium-sized and large entities includes specific standards in DAS 630 for 'Commercial foundations and associations' (see paragraph 40.3). A commercial foundation or association must also apply the other chapters of the Dutch Accounting Standards for medium-sized and large entities to both its commercial and other activities (DAS 630.109). Small commercial foundations and associations are subject to the Dutch Accounting Standards for micro-sized and small legal entities. The Dutch Accounting Standards for micro-sized and small legal entities bundle does not contain a specific chapter for small commercial foundations and associations. The criteria for determining the size of an entity are discussed in paragraph 1.5. Those criteria also apply to commercial foundations and associations.

40.2.4 Obligations to prepare financial statements

The preparation of financial statements is the legal responsibility of the management board of the commercial foundation or association. This fits within the Dutch legal system where the management board, subject to restrictions according to the articles of association, has the task of managing the foundation or association. The management board should act in the interest of the foundation or association and its related activities. Primarily as part of its management role, the management board has a number of powers and obligations. For example, the management board is responsible for managing the finances, keeping proper records of the foundation's or association's financial position and activities and retaining administrative data for the legal period of seven years (Article 2:10 NCC). By preparing the financial statements, the management board also accounts for its policies and management. The financial statements so prepared should then be adopted (see paragraph 40.2.7).

40.2.5 Deadline for preparation of financial statements

The management board of a commercial foundation or association is required to prepare the foundation's or association's balance sheet and statement of income and expenses annually within six months of the end of the financial year (Article 2:10(2) NCC). Within this period, the management board will also submit the management board report for inspection at the offices of the foundation or association (Articles 2:49 and 300 NCC). Pursuant to Article 2:392(1) NCC, some information of various kinds must also be added to the financial statements and the management board report (see paragraph 40.2.9.4), unless the exemption for group entities of Article 2:403 NCC applies (see paragraph 1.7). The preparation of the management board report is not required if it concerns a small foundation or association (Article 2:396(7) NCC, see paragraph 1.5), or if the exemption for group entities of Article 2:403 NCC is applied.

Based on special circumstances, in the case of commercial foundations and associations, the six-month deadline for preparing financial statements can be extended by up to four months (Articles 2:49(1) and 300(1) NCC respectively). In commercial associations, the deferral is granted by the general members’ meeting. For commercial foundations, the deferral is granted by the body that adopts the financial statements according to the articles of association. If there is no provision for this in the articles of association, this power belongs to the supervisory board and, failing this, to the management board.

40.2.6 Signing financial statements

The financial statements of commercial foundations and associations must be signed by the management board members and by the supervisory board members. Supervisory board members are those persons entrusted by the articles of association with the supervision of the management board (DAS 940). By signing the financial statements, the management board members and supervisory board members assume responsibility for the financial statements. If the signature of one or more management board members or supervisory board members is missing, the reason must be disclosed in the financial statements (Articles 2:49(2) and 300(2) NCC).
If the management is performed by an entity, the signing of the financial statements will include the name of that entity and the signing on behalf of that entity will be done by one or more natural persons authorised to do so.

40.2.7 Adoption of financial statements

For commercial foundations, adoption is done by the body designated for that purpose according to the articles of association. If the articles of association do not designate a body, the adoption is done by the supervisory board. In the absence of a supervisory board, the management board shall adopt the financial statements (Article 2:300(3) NCC). The financial statements must be adopted no later than one month after the end of the period within which the financial statements must be prepared (Article 2:300(3) NCC).

In commercial associations, the adoption of the financial statements is done by the general members’ meeting. The management board must hold this meeting no later than one month after the end of the period within which the financial statements must be prepared, (Article 2:49(3) NCC).

A commercial foundation and association may request the Minister of Economic Affairs to grant an exemption from the obligation to prepare, submit to the supervisory board and adopt financial statements for compelling reasons (Articles 2:49(6) and 300(5) NCC).

The adoption of the financial statements of commercial foundations and associations can only take place after the competent body has been able to take cognisance of the auditor's report, unless a legal basis is disclosed under Other information why the report is missing (Article 2:393(7) NCC).

40.2.8 Discharge of management board members and supervisory board members

For commercial associations, the law states that adoption of the financial statements by the general members' meeting does not automatically imply the discharge of management board members and supervisory board members. At the general members' meeting, the adoption of the financial statements and the discharge of management board members and supervisory board members must therefore be dealt with as two separate agenda items (Article 2:49(3) NCC).

For commercial foundations, this provision is not included in the law. Where a commercial foundation has a supervisory board, we recommend that the discharge of the management board be dealt with as a separate agenda item at the supervisory board meeting, alongside the adoption of the financial statements.

40.2.9 Components of the annual report

General
The annual accounts consist of:

- the financial statements;
- the management board report; and
- the Other information (as applicable).

The collective term 'annual accounts' or 'annual report' is also used for the entirety of the management board report, the financial statements and the Other information. The financial statements mean the company-only financial statements consisting of the balance sheet and the statement of income and expenses with the notes, and the consolidated financial statements if the commercial foundation or association prepares consolidated financial statements.

Financial statements
The financial statements must provide such an insight that a responsible opinion can be formed on the equity and profit or loss and, as far as the nature of financial statements allows, on solvency and liquidity (Article 2:362(1) NCC). This is the main rule of Title 9 Book 2 NCC that underlies the Dutch Accounting Standards. In addition, the law provides many specific rules. If the disclosures are insufficient according to the specific provisions of the law, additional disclosures should be made in the financial statements (Article 2:362(4) NCC). If the law requires disclosures that are not relevant to a specific commercial foundation or association, such disclosure may be omitted.

Only in exceptional cases, namely if this is necessary to provide the required insight into equity and profit or loss, can the specific requirements of Title 9 Book 2 NCC be deviated from. The reason for this deviation and (to the extent necessary) its effect on equity and profit or loss must be disclosed in the notes (Article 2:362(4) NCC). Deviation from the authoritative statements of the Dutch Accounting Standards Board is only possible if it improves the required insight (DAS 100.407).

Management board report
The management board report is a written report in which the management board accounts for the course of business of the commercial foundation or association and the policies pursued during the reporting period and announces the expected course of business. Where a supervisory board is present, a report of the supervisory board may be added to the management board report in which the supervisory board accounts for the performance of its supervisory role.

For the management board report of commercial foundations and associations, the provisions of Title 9 Book 2 NCC of Article 2:391 NCC and the provisions of DAS 400 Management Board Report apply. See paragraph 1.1.6.3.

Other information
For commercial foundations and associations, the law requires the management board to add some information of various kinds to financial statements and management board report in the Other Information section, unless Article 2:403 NCC applies. See paragraph 1.1.6.4 for the Other information. Specifically for commercial foundations and associations, this includes the following information (Article 2:392(1) NCC):

1. the auditor's report (audit opinion) or a disclosure as to why it is missing; and

2. a list of existing branches and the countries in which there are branches, as well as their trade name if different from that of the foundation or association.

Commercial foundations and associations need not include the statutory provisions on the appropriation of profit or loss under Other information (Article 2:392(5) NCC). Pursuant to Article 2:383a NCC this information must be disclosed in the notes to the financial statements.

With regard to the statutory provisions on the appropriation of profit or loss, we also note that associations are prohibited from distributing profits to their members (Article 2:26(3) NCC). Foundations are not allowed to make distributions unless they are distributions with non-commercial or social purposes to others than the founders or members of bodies of the foundation (Article 2:285(3) NCC).

Small commercial foundations and associations are exempt from publishing the Other information (Article 2:396(8) NCC).

40.2.10 Publication

Commercial foundations and associations have a legal duty to publish their annual accounts. Paragraph 1.6 discusses the publication requirement applicable to these foundations and associations. It also discusses the possible sanctions for failure to comply with the legal publication requirement.

Small commercial not-for-profit-profit foundations and associations
For a small commercial foundation or association that does not aim to make a profit, the law contains the possibility of full exemption from publication of the financial statements (Article 2:396(9) NCC). To be able to make use of this exemption, the following requirements must be met (Article 2:396(9) NCC):

- the small commercial foundation or association does not aim to make a profit;
- the annual accounts, i.e. the annual accounts that every other small commercial foundation or association is required to publish, must be available for inspection at the offices of this small commercial foundation or association or will be sent free of charge to all creditors or members on request; and
- a report from a public auditor must be filed with the Trade Register, certifying that the commercial foundation or association did not carry out any activities outside the purpose statement during the financial year and that this publication exemption applies to the commercial foundation or association.

40.2.11 Providing financial statements to works council

Under the Works Councils Act (WOR), a company that generally employs at least 50 people must establish a works council (OR) (Article 2(1) WOR). The financial statements and the management board report in the Dutch language and the Other information to be attached thereto must be provided to the works council for discussion as soon as possible after the adoption of the financial statements. This obligation also applies to commercial foundations and associations (Article 31a (2) WOR).

The Decree on provision of financial information to works councils 1985 stipulates that, among other things, foundations and associations are obliged to provide works councils with the annual accounts of the business for which the works council has been established within six months of the end of the financial year, for discussion. These annual accounts are prepared in accordance with the requirements of the Decree and consist, in summary, of an abridged balance sheet and statement of income and expenses with notes and, if available, the auditor's report accompanying these annual accounts.

The financial statements of the commercial foundation or association may relate to more than one company. In that case, the works council must also be provided with written information that allows it to form a picture of the extent to which the company for which the works council has been established has contributed to the joint profit or loss (Article 31a(4) WOR). If the financial data of the company for which the works council is established are included in consolidated financial statements, these consolidated financial statements should (also) be provided to the works council (Article 31a(3) WOR).

40.3 Specific provisions on financial statements

40.3.1 Applicable standards

If a foundation or association with business activities falls under Title 9 Book 2 NCC, it applies to the totality of its activities and therefore not only to its corporate activities (DAS 630.108). The financial statements relate to the foundation or association which includes the business maintained by that foundation or association: it concerns the financial statements of the foundation or association. In that case, the Dutch Accounting Standards also apply accordingly to both the commercial and other activities of the commercial foundation or association. The general standards applicable to commercial foundations and associations are set out in DAS 630 'Commercial foundations and associations'. In addition, the specific standards for special industries (e.g. fundraising organisations) may apply. This is the case if the commercial foundation or association also meets the criteria for those special industries. In that case, the specific standards for the particular special industry take precedence over application of the general standards of DAS 630 (DAS 630.109). This chapter deals only with the provisions of DAS 630.

It may also be that a commercial foundation or association is also a not-for-profit organisation. In that case, by virtue of its commercial activities, Title 9 Book 2 NCC (and DAS 630) applies to the financial statements to be prepared by the foundation or association. Moreover, certain requirements of DAS 640 'Not-for-profit Organisations' or DASsmall C1 'Small Not-for-profit Organisations' – as described in Chapter 41 – may then be relevant for providing the required insight. In that case, it is strongly recommended that the requirements of DAS 640 or DASsmall C1 also be applied (DAS 640.103). This may mean, for example, that such foundations and associations include budget figures in the statement of income and expenses (under DAS 640.305 and DASsmall C1.303, respectively). See also Chapter 41 for the treatment of reporting requirements for not-for-profit organisations.

Example: Qualifying as a commercial foundation or association

Foundation A has two separate activities, namely childcare and welfare activities for the elderly. Childcare is a commercial activity. Its net revenue is around EUR 8 million a year. Welfare activities include maintaining a meeting centre for the elderly. For the welfare activities, foundation A receives an operating grant from the municipality of about EUR 34 million a year. In addition, foundation A has income from the catering facility at the meeting centre of about EUR 0.5 million a year. By virtue of its welfare activities, foundation A is a not-for-profit organisation as defined in DAS 640.

Foundation A's net revenue from business activities is EUR 8.5 million, exceeding the limit of EUR 6 million. On this basis, Title 9 Book 2 NCC and DAS 630 apply to foundation A. In addition, foundation A follows the rules of DAS 640.

If a commercial foundation or association carries out other activities besides business activities, information on the nature and extent of both types of activities should be disclosed in the notes (DAS 630.307).

40.3.2 General disclosures in the notes

A foundation or association must disclose in the notes the standards according to which the financial statements have been prepared (Article 2:362(10) NCC). For commercial foundations and associations, this will usually be Title 9 Book 2 NCC. Article 2:362(8) NCC also allows a commercial foundation or association to prepare financial statements in accordance with IFRS-EU. See paragraph 1.2.

All foundations and associations that maintain a business that must be registered in the Trade Register must disclose the net revenue of the business in the statement of income and expenses (exploitatierekening or staat van baten en lasten) (Article 2:48(3) and Article 2:299(a) NCC respectively). This also applies if a foundation or association with business activities does not fall under Title 9 Book 2 NCC, because net revenue is lower than the threshold amount of EUR 6 million. Its purpose is to be able to determine whether the foundation or association is subject to the obligation of Title 9 Book 2 NCC to prepare and publish financial statements (DAS 630.306). This information only needs to be included in the publication documents if it results from the application of Title 9 Book 2 NCC. The obligation to publish this information therefore only applies to medium-sized and large commercial foundations and associations.

40.3.3 Balance sheet and profit and loss account formats

The Decree on annual accounts format (BMJ) applies only to public limited liability entities and private limited liability entities, according to Article 1 of this Decree. However, for the purpose of providing insight, this Decree should be applied accordingly by the commercial foundation and association (DAS 630.201).

The BMJ contains a number of detailed formats to be applied for the presentation of the balance sheet and profit and loss account. Those formats may only be modified to a limited extent. Among other things, the Decree provides that:

- the order of items is that of the chosen format (Article 6(1) BMJ);
- the names fixed assets, current assets, current debt, non-current debt, provisions and equity may not be deviated from (Article 5(1) BMJ);
- other names may only be replaced by names that are at least as clear (Article 5(2) BMJ);
- subtotals may be inserted and named (Article 5(3) BMJ) and items may be broken down (Article 7(1) BMJ); and
- items may be inserted to the extent that their content is not covered by an item specified in the chosen format (that is not marked 'other') (Article 7(2) BMJ).

If the commercial foundation or association also has non-business activities, new headings should be added for the income and expenses from them, based on the nature of the activities (DAS 630.201).

For the formats and full text of the BMJ, please refer to Annex 6 of this manual.

40.3.4 Pricing principles

Sometimes a commercial foundation or association can acquire goods and services at below-market prices and rates because of its special nature, for example, because of its charitable objectives. This may also have beneficial effects on its business activities. This makes comparison with businesses with which it competes difficult. If assets have been recognised on the balance sheet, or expenses have been recognised at prices significantly different from market prices, the Dutch Accounting Standards Board recommends that this is disclosed in the notes, with an explanation of the pricing principles applied and, if possible, a quantification of the effect on the financial statements (DAS 630.301).

40.3.5 Equity

Article 2:373(1) NCC stipulates that under equity the following should be recorded separately: issued capital, share premium, revaluation reserves, other legal reserves, statutory reserves, other reserves and undistributed profits. Issued capital and share premium cannot occur in foundations and associations.

DAS 630 distinguishes between freely disposable equity and restricted equity. Equity should be presented (on the balance sheet or in the notes) in such a way that it is clear what portion is freely disposable. For this purpose, the following distinction within equity is important (DAS630.202):

- foundation capital;
- revaluation reserve;
- other legal reserves;
- statutory reserves;
- appropriated funds;
- appropriated reserves; and
- other reserves.

An equity movement schedule must be provided for all equity items (Article 2:378(1) NCC). The equity movement schedules must also include the comparative figures for the previous financial year (DAS 240.237).

Foundation capital
In the case of a commercial foundation, if initial capital is contributed at establishment, that part of the equity is referred to as foundation capital (DAS 630.203).

Revaluation reserve and other legal reserves
Because commercial foundations and associations are subject to Title 9 Book 2 NCC, they must hold reserves in situations where required by law (the legal reserves). For capital protection reasons, there is no need to prescribe legal reserves for foundations and associations (since they are not allowed to make distributions to members or founders or to those who are part of its bodies). However, Title 9 Book 2 NCC does not contain an exemption provision. The Dutch Accounting Standards therefore state that in the case of commercial foundations or associations, the provisions of Title 9 Book 2 NCC for the recognition of legal reserves apply (DAS 630.204).

The legal reserves that may apply to commercial foundations and associations include the revaluation reserve (see paragraph 14.3.7) and the other legal reserves (paragraph 14.3.8), namely the:

- reserve for capitalised development costs;
- reserve for participating interests; and
- foreign currency translation reserve.

Statutory reserves
If the articles of association prescribe that certain reserves with restricted spending options be created, the commercial foundation or association should disclose in the notes the amount of the reserve and the essence of the arrangement under the articles of association (DAS 630.305).

Appropriated funds and appropriated reserves
Within equity of commercial foundations and associations, a distinction is made between appropriated funds (DAS 630.205) and appropriated reserves (DAS 630.206). The relevant provisions are similar in substance to the provisions for not-for-profit organisations in DAS 640. Appropriated funds are part of restricted equity. Appropriated reserves are essentially freely disposable equity. For this, see paragraph 41.2.3.2. The notes should state the amount and restricted objective of each appropriated fund and appropriated reserve. In addition, for each appropriated fund, the reason for the restricted objective as well as any other conditions imposed by third parties must be disclosed (DAS 630.303). For each appropriated reserve, it must be stated that the restricted objective was made by the management board or the general meeting of members (DAS 630.304).

40.3.6 Profit and loss account or statement of income and expense (exploitatierekening)

Name
Commercial foundations and associations do not record a statement of income and expenses in the annual accounts, but a profit and loss account. The profit and loss account is replaced by a statement of income and expense (exploitatierekening) if it serves the legally required insight (Article 2:361(2) NCC). The legal provisions concerning the profit and loss account are applied accordingly to this statement of income and expense (exploitatierekening) as far as possible (DAS 630.208).

Net revenue
Net revenue means the revenue from the provision of goods and services arising from the entity's operations less discounts etc. and taxes levied on that revenue (Article 2:377(6) NCC). It follows from the term 'operations' in this description that the commercial association and foundation should understand by net revenue only the income from the business(es) they operate, i.e. not the income from their other activities (DAS 630.209). For a more detailed explanation of the term 'net revenue', see paragraphs 26.8 and 40.1.3.

40.3.7 Remuneration of management board and supervisory board members

Article 2:383(1) NCC requires that the notes disclose the remuneration of management board members and supervisory board members. This refers to the persons who are part of the management board within the meaning of Book 2 NCC, i.e. the managing body according to the articles of association, or the body that supervises the management board's policy and the general course of business, respectively. The members of the management board as referred to in Articles 2:291(1) and 44(1) NCC respectively act as management board members of a foundation and an association. The supervisory board members of a foundation and an association, for the purposes of Article 2:383(1) NCC, are those persons who, where applicable, are charged with the supervision of the management board by virtue of the articles of association. See also paragraph 18.8.

If a commercial foundation or association falls within the scope of the WNT, the resulting disclosure requirements apply. See paragraph 41.2.4.8.

40.3.8 Appropriation of profit or loss

Commercial foundations and associations must disclose in the notes both the arrangement on the appropriation of profit or loss according to the articles of association and the manner in which profit or loss after tax is appropriated (Article 2:383(a) NCC/DAS 630.302). According to the Explanatory Memorandum, the legislator's thinking is that it is precisely in foundations and associations that are not allowed to distribute profits to the founders and members that there is interest in what happens to the profit or loss.

40.3.9 Consolidation

Chapter 33 deals with the consolidation obligation and consolidation scope of entities based on Title 9 Book 2 NCC and DAS 217 'Consolidation'. Chapter 33 also applies to commercial foundations and associations.
Paragraph 41.3 provides guidance on determining whether a group relationship exists in the case of foundations and associations. That paragraph also applies to commercial foundations and associations.

40.4 Exemptions for small and medium-sized commercial foundations and associations

The exemptions for the financial statements to be prepared by commercial foundations and associations are the same as for other entities to which Title 9 Book 2 NCC applies. Please refer to the other chapters of this manual, which deal with the individual items of the financial statements. Furthermore, a commercial foundation or association may fall under the regime of micro-sized entities. See Chapter 39.

40.5 Significant differences from IFRS

Provisions for commercial foundations and associations
Title 9 Book 2 NCC and the Dutch Accounting Standards have specific provisions for the annual reporting of commercial foundations and associations. IFRS has no specific provisions for the annual reporting of commercial foundations and associations.

41 Non-commercial foundations and associations

41.1 Annual reporting in general

41.1.1 Introduction

Title 9 Book 2 NCC forms the basis of Dutch accounting and reporting rules. However, the provisions of Title 9 Book 2 NCC do not apply to foundations and associations, unless they are commercial foundations and associations (see Chapter 40 for commercial foundations and associations). This chapter applies to non-commercial foundations and associations; these are foundations and associations to which Title 9 Book 2 NCC does not apply, but which choose to prepare their financial statements in accordance with the Dutch Accounting Standards. Non-commercial foundations and associations are also referred to as not-for-profit organisations. In the remainder of this chapter, these non-commercial foundations and associations are referred to as 'foundations and associations'.

An association is an entity that has members and is dedicated to a particular purpose. That purpose may not be to meet certain material needs of its members by entering into agreements with those members in the business carried on for the members' benefit. For, in that case, it would be a cooperative. An association may not distribute profits to its members (Article 2:26 NCC).

A foundation is an entity without members, which aims to achieve a purpose stated in its articles of association using appropriated equity. This purpose may not include making distributions to founders or to those who form part of its bodies. Nor may this purpose include making distributions to others unless such distributions have an idealistic or social purpose (Article 2:285 NCC).

This chapter does not deal with the annual reporting of foundations and associations that have opted not to apply the Dutch Accounting Standards when preparing their financial statements. The annual reporting of those foundations and associations are only subject to Article 2:10 NCC. Article 2:10 NCC regulates the record-keeping obligation and applies to all entities covered by Book 2 NCC, including foundations and associations. For example, a local sports association may decide not to prepare its financial statements based on the Dutch Accounting Standards. If an auditor audits or reviews the financial statements of a foundation or association, the financial statements of the foundation or association will have to be prepared in accordance with acceptable accounting policies, such as the Dutch Accounting Standards. Without acceptable accounting policies, a management board has no appropriate basis for preparing the financial statements and the auditor has no appropriate criteria for auditing or reviewing the financial statements (Additional Audit instructions and Other Standards NV COS 220).

Paragraph 41.1 of this chapter provides a general consideration of the laws and regulations applicable to foundations and associations. Paragraphs 41.2 to 41.5 deal successively with the financial statements of foundations and associations, consolidation, recognition of mergers and acquisitions and the management board report.

41.1.2 General accounting and record-keeping obligation

Article 2:10 NCC sets out the general record-keeping obligation. This obligation applies to all entities that are subject to Book 2 NCC, including foundations and associations. This article prescribes that the management board is obliged to keep such records of the foundation's or association's rights and obligations that the foundation's or association's rights and obligations can be known from them at any time. Furthermore, the management board is obliged to keep the books and the balance sheet and statement of income and expenses for seven years (Article 2:10(1) and (3) NCC). The management board is obliged to prepare the balance sheet and statement of income and expenses of the foundation or association annually within six months of the end of the financial year (Article 2:10(2) NCC).

With the exception of Article 2:10(2) NCC, foundations and associations are not subject to general legal provisions on the presentation of the financial statements.

41.1.3 Objective of financial statements

The objective of a commercial company's financial statements is to provide information about its financial position, profit or loss and changes in financial position which is useful to a wide range of users for making economic decisions. Unlike commercial companies, foundations and associations do not have profit as their primary objective. They are usually primarily dedicated to a church, ideological, social, charitable, cultural or scientific objective or otherwise pursue a social purpose or public benefit (DAS 640.101). Foundations and associations are therefore mostly not-for-profit organisations. To achieve its objectives, however, the organisation must have sufficient cash, it must be able to finance its activities and its financial position must be such as to ensure going concern. In fact, this results in financial objectives that are preconditions for achieving the primary objectives. The financial statements of a not-for-profit organisation focus on providing information about those financial pre-conditions: information on the financial position, operating income and expenses and changes in the financial position.

41.1.4 Dutch Accounting Standards and application of size criteria

In the absence of a legal obligation, foundations and associations may choose not to prepare their financial statements in accordance with generally accepted accounting principles. They will opt for this especially if the financial statements are only intended for a limited circle of users and are not aimed at general use by the public. Examples are a local sports club or a homeowners' association. As mentioned in the introduction, this chapter does not deal with the annual reporting of such foundations and associations.

However, in the case of financial statements aimed at general use by the public, it is important for the management board of a foundation or association to be guided in its choice of accounting principles by the purpose of the financial statements and generally accepted standards. Since the purpose of the financial statements of a not-for-profit organisation is to provide information on its financial position, operating income and expenses and changes in its financial position, it is important to provide users of the financial statements with proper insight into equity and profit or loss and into operations and their outcomes. To provide this insight, it is strongly recommended to follow the provisions of the Dutch Accounting Standards. For, in the Netherlands, these standards are an interpretation of generally accepted financial reporting standards.

The Dutch Accounting Standards for medium-sized and large entities contain standards for medium-sized and large foundations and associations, with specific standards in DAS 640 'Not-for-profit organisations'. The criteria for determining the size of an entity are discussed in paragraph 1.5. Those criteria also apply to foundations and associations. In addition, the extent and depth of reporting of foundations and associations will depend partly on the specific nature, complexity of the organisation and the group of users, their information needs and their position in relation to the foundation or association. The trade-off between the costs of preparation and the benefits (relevance to users) plays an important role here (DAS 640.102).

This implies an own responsibility of the management board of the reporting foundation or association for its financial statements. In the opinion of the Dutch Accounting Standards Board, the Dutch Accounting Standards, and in particular the authoritative statements contained therein, generally contribute to the required insight into equity and profit or loss. It can therefore be argued that deviation from these authoritative statements is only possible if it improves the required insight (DAS 100.407) (see also paragraph 2.3).

If an auditor audits the financial statements of a foundation or association, that auditor must have general accounting policies (acceptable standards) against which to measure whether the financial statements meet the requirements to be imposed on them. In that case, the foundation's or association's financial statements must therefore be prepared in accordance with general accounting policies, such as the Dutch Accounting Standards. Importantly, even then, the comprehensiveness of reporting depends, among other things, on the specific nature of the foundation or association and its size and complexity (DAS 640.102).

Apart from the aforementioned specific standard (DAS 640), the general standards of the Dutch Accounting Standards for medium-sized and large entities - which apply to all entities - apply in full (DAS 640.102). It is recommended to disclose in the notes to the financial statements that the Dutch Accounting Standards have been followed. Such disclosure is only permissible if the Standards have been applied in full (DAS 640.106).

41.1.5 Specific legal financial statement obligations

A number of foundations and associations are subject to specific legal regulations on the presentation of the financial statements. This applies, for example, to healthcare providers (Regulations on public annual reporting under the Healthcare (Market Regulation) Act) and educational institutions (Annual Reporting Regulations for Educational Institutions). Annual reporting by such specific foundations and associations is not covered in this manual.

In addition, other specific laws or regulations may apply, or grant rules may contain specific provisions. Those specific provisions may (partly) deviate from the provisions in the Dutch Accounting Standards. In such cases, the specific laws, regulations and grant rules take precedence over the authoritative statements of the Dutch Accounting Standards Board. By means of additional information, the notes should also provide the information required by those standards (DAS 640.104).

41.1.6 Obligations for preparation of financial statements

The preparation of financial statements is the legal responsibility of the management board of the foundation or association (Article 2:10 NCC). This fits within the Dutch legal system where the management board, subject to restrictions according to the articles of association, has the task of managing the foundation or association. The management board should focus on the interest of the foundation or association and its related activities. Primarily as part of its management role, the management board has a number of powers and obligations. For example, the management board is responsible for managing the finances, keeping proper records of the assets and activities of the foundation or association and retaining administrative data for the legal period of seven years (Article 2:10 NCC). By preparing the financial statements, the management board also accounts for its policies and management. The financial statements thus prepared must then be adopted (see paragraph 41.1.9).

41.1.7 Deadline for preparing financial statements

The management board of a foundation or association is obliged to prepare the balance sheet and statement of income and expenses of the foundation or association annually within six months of the end of the financial year (Article 2:10(2) NCC). In the case of associations, there is the possibility of extending the deadline for preparing the financial statements (Article 2:48(1) NCC). The law does not provide for the period by which this deadline can be extended. It may be assumed that by analogy with the rules for commercial foundations and associations (see paragraph 40.2.5), a four-month extension period for associations is reasonable.

The law does not provide for an extension option for foundations. This means that the financial statements of foundations must be prepared within six months of the end of the financial year.

41.1.8 Signing of financial statements

The financial statements of associations must be signed by the management board members and by the supervisory board members. Supervisory board members are defined as those persons who are entrusted by the articles of association with the supervision of the management board (DAS 640.0). By signing the financial statements, the management board members and supervisory board members take responsibility for the financial statements. If the signature of one or more management board members or supervisory board members is missing, the reason for this must be disclosed in the financial statements (Article 2:48(1) NCC). The financial statements are signed by the management board members and supervisory board members functioning at the time the financial statements are prepared. This may mean that management board members and supervisory board members take responsibility for financial statements that relate to a period (or part of a period) when they were not in function.

For foundations, there is no legal requirement for the management board members and supervisory board members to sign the financial statements.

If the management is performed by an entity, the signing of the financial statements will include the name of the entity-director and the signing on behalf of that entity will have to be done by one or more natural persons authorised to do so.

41.1.9 Adoption of financial statements

Article 2:48(1) NCC stipulates that the management board of an association must submit the balance sheet and the statement of income and expenses with explanatory notes to the general members' meeting for approval. The general members' meeting is held within six months of the end of the financial year; the general members' meeting may extend this period.

There are no provisions in the law regarding the adoption of the financial statements of foundations. Provisions on adoption and/or approval are usually (also) included in the articles of association.

41.1.10 Discharge of management board members and supervisory board members

In the case of foundations, there is no general members' meeting that can discharge the management board members and supervisory board members. However, when a foundation has a supervisory board, the supervisory board can discharge the management board. Where a foundation has a supervisory board, we recommend that the discharge of the management board be dealt with as a separate agenda item at the supervisory board meeting, alongside the adoption of the financial statements.

In the case of associations, the general members' meeting adopts the financial statements and discharges the directors. We recommend, by analogy with commercial associations (see paragraph 40.2.8), that the adoption of the financial statements and the discharge of management board members (and possibly supervisory board members) be treated as two separate agenda items at the general members' meeting.

41.1.11 Components of the annual report

41.1.11.1 General

The annual accounts consist of:

- the financial statements;
- the management board report;
- the Other information (as applicable).

The collective term 'annual accounts' or 'annual report' is also used for the entirety of the management board report, the financial statements and the Other information. The financial statements mean the company-only financial statements consisting of the balance sheet and the statement of income and expenses with the notes, and the consolidated financial statements if the foundation or association prepares consolidated financial statements.

41.1.11.2 Financial statements

If a foundation or association chooses to prepare its financial statements in accordance with the Dutch Accounting Standards, those financial statements must provide such insight that a responsible opinion can be formed on the equity and profit or loss, as well as, to the extent permitted by the nature of financial statements, on solvency and liquidity (Article 2:362(1) NCC). This is the main rule of Title 9 Book 2 NCC that underlies the Dutch Accounting Standards. In addition, the law gives many specific rules. If the disclosures are insufficient according to the specific provisions of the law, additional disclosures should be made in the financial statements (Article 2:362(4) NCC). If the law requires information that is not relevant to a specific foundation or association, such information may be omitted. The extent and depth of reporting of foundations and associations will partly depend on the specific nature, complexity of the organisation and the group of users, their information needs and their position in relation to the foundation or association. The trade-off between costs and benefits (relevance to users) plays an important role here (DAS 640.102).

Only in exceptional cases, namely if this is necessary to provide the required insight into the equity and profit or loss, can the specific requirements of Title 9 Book 2 NCC be deviated from. The reason for this deviation and (to the extent necessary) its effect on the equity and profit or loss must be disclosed in the notes (Article 2:362(4) NCC). Deviation from the authoritative statements of the Dutch Accounting Standards Board is only possible if it improves the required insight (DAS 100.407).

41.1.11.3 Management board report

The management board report is a written report in which the management board accounts for the affairs of the foundation or association and the policy pursued during the reporting period and announces the expected developments. If there is a supervisory board, a report of the supervisory board may be added to the management board report in which the supervisory board accounts for the performance of its supervisory task.

The management board report of foundations and associations has special significance. The nature of the activities may entail that their social significance can only be reflected in the financial statements to a limited extent. Therefore, the Dutch Accounting Standards include specific guidelines for the management board report of foundations and associations (DAS 640.512-519).

In the case of associations, there is a legal obligation to prepare a management board report describing the affairs of the association and the policies pursued (Article 2:48(1) NCC). The management board report is prepared at the same time as the financial statements and submitted to the members' meeting, the supervisory board and/or the body competent under the articles of association.

The content of the management board report of foundations and associations is described in more detail in paragraph 41.5.

41.1.11.4 Other information

Where appropriate, the annual reporting of foundations and associations should include the auditor's report (audit opinion) under the heading Other information (DAS 640.303).

In addition, the Other information should include the existence of any branch offices (branches) and of the countries in which branch offices exist, as well as their trade names if they are different from that of the organisation (Article 2:392(1) NCC).

41.1.12 Publication

Legal obligation
Foundations and associations, as Title 9 Book 2 NCC does not apply, have no legal obligation to publish their annual accounts. Of course, such publication is allowed. By virtue of their social responsibility, many foundations and associations voluntarily publish their annual accounts. Given the mostly social significance of not-for-profit organisations, the Dutch Accounting Standards Board recommends that the annual accounts be made available to stakeholders and interested parties as soon as they are adopted by the competent bodies (DAS 640.521).

Some foundations and associations (also) publish an abridged report. An abridged report should not deviate in content from the official, adopted report, analogous to the rules in Article 2:395(2) NCC.

Future legislation
In November 2020, the Civil Society Organisations Transparency Bill (wetsvoorstel Transparantie Maatschappelijke Organisaties, WMTO) was presented to the House of Representatives. This law aims to counter unwanted influence via foreign money flows on Dutch political, civil society or religious organisations. The first part of the bill focuses on the obligation for certain civil society organisations to provide, under conditions, insight into the size, origin and purpose of foreign donations obtained, at the request of the mayor, the public prosecution service and designated government agencies. The second part of the bill includes the obligation for foundations to file the balance sheet and statement of income and expenses with the Trade Register no later than 10 months after the end of the financial year. The bill contains no requirements aimed at the form and content of the balance sheet and statement of income and expenses to be filed. In addition, no audit is required.

A note following the report ('nota naar aanleiding van het verslag') was published in May 2023 in which the minister answered questions from the House of Representatives. It is not yet known when this legislation will be finalised.

41.1.13 Provision of financial statements to the works council

Under the Works Councils Act (Wet op de ondernemingsraden, WOR), a company that generally employs at least 50 people must establish a works council (Article 2(1) WOR). The financial statements and the management board report in the Dutch language and the Other Information to be attached thereto must be provided to the works council for discussion as soon as possible after the adoption of the financial statements. This obligation also applies to foundations and associations that are not commercial foundations or associations, but which do maintain a business subject to the works council obligation: in that case, the company must (designated by order in council) provide substitute written information to the works council (Article 31a(5) WOR). The Decree on the Provision of Financial Information to Works Councils 1985 stipulates that, among other things, foundations and associations subject to the works council obligation must provide the annual accounts of the company for which the works council has been established to the works council for discussion within six months of the end of the financial year. These annual accounts are prepared in accordance with the requirements of the Decree and consist, in summary, of a concise balance sheet and statement of income and expenses with notes and, if available, the auditor's opinion accompanying these annual accounts.

The financial statements of the foundation or association may relate to more than one company. In that case, the works council must also be provided with written information that allows the works council to form a picture of the extent to which the company for which the works council has been established has contributed to the joint profit or loss (Article 31a(4) WOR). If the financial data of the company for which the works council has been established are included in consolidated financial statements, these consolidated financial statements must (also) be provided to the works council (Article 31a(3) WOR).

41.2 The financial statements

41.2.1 Introduction

The financial statements of a foundation or association include at least the following parts (DAS 640.301):

- the balance sheet;
- the statement of income and expenses; and
- the notes to the balance sheet and the statement of income and expenses.

In addition, foundations and associations are strongly recommended to prepare a cash flow statement (DAS 640.304). If consolidated financial statements are prepared, the cash flow statement is included on a consolidated basis (DAS 640.507). A company-only cash flow statement only needs to be prepared in the absence of consolidated financial statements (DAS 360.106). The cash flow statement is subject to the provisions of DAS360 'The cash flow statement'. See Chapter 25.

A foundation or association that heads a group must prepare consolidated financial statements (DAS 640.501). The consolidated financial statements are discussed in paragraph 41.3.

41.2.2 General

In DAS 640, the Dutch Accounting Standards Board has issued standards specific to the reporting of foundations and associations. In addition, the general standards - which apply to all entities - apply in full to foundations and associations (DAS 640.102). This means that the remaining chapters of this manual also apply to foundations and associations. For example, even for foundations and associations, the fact that a tangible fixed asset is used by the foundation or association normally implies that future economic benefits accrue to the foundation or association and capitalisation must take place.

Example: Capitalisation of assets

A foundation operating a museum decides to use surpluses from past years' operations partly to buy computers that will be used in the museum's (administrative) activities. The computers have an expected useful life of four years. The purchase cost of the computers is capitalised and depreciated over four years. For the computers will be used for the museum's activities for several years, so the future economic benefits of the computers accrue to the foundation. The carrying amount of this asset and the carrying amounts of related assets are reviewed for impairment, if applicable (see Chapter 10).

When applying the other chapters, the specific nature of the foundation or association must, of course, be taken into account. An entity is required to assess, on each reporting date, whether there are any external or internal indications that an asset may be impaired. This applies to all fixed assets. For example, for tangible fixed assets, such as office buildings and furniture and equipment. DAS 121.203 lists a number of indications that are to be included in the assessment as a minimum. See Chapter 10. An indicator that can often be relevant in foundations and associations concerns a negative net cash flow or negative operating profit or loss from assets. This may be evident, for example, when preparing figures from the current period and budgeted figures for the future. Besides being alert to the indications of DAS 121, a foundation or association should also be critical of any other relevant events and information. Their impact on the measurement of fixed assets will have to be determined time and time again.

This chapter addresses the specific provisions applicable to foundations and associations, in addition to the other chapters of this manual.

Specific laws or regulations may apply, or grant rules may contain specific provisions for reporting by a foundation or association. Those specific provisions may (partly) deviate from the provisions in the Dutch Accounting Standards. In such cases, the specific laws, regulations and grant rules take precedence over the authoritative statements of the Dutch Accounting Standards Board. By means of additional information, the notes should also provide the information required by those standards (DAS 640.104).

Segmented information
If the foundation or association carries out very different types of activities and/or performs activities at very different locations, the relevant items of the balance sheet and statement of income and expenses should be segmented for each main group of activities and locations respectively (DAS 640.510). Information about different activities and locations (segmented information) is relevant to understand the returns and risks, efficiency and effectiveness of these activities and their future development (DAS 640.511).

When classifying by main groups, the foundation or association can refer to DAS 350 'Segmented information', paragraphs 2 and 3. This standard recommends deriving segmented information from the internal information presented to the management board. See paragraph 30.6 for a content description.

General notes
It is recommended to indicate in the notes to the financial statements that the Dutch Accounting Standards have been followed. Such disclosure is only permissible if the Dutch Accounting Standards have been applied in full (DAS 640.401).

The foundation or association must disclose the name under the articles of association, registered office and legal form in the notes (DAS 640.401a).

Where applicable, the notes should disclose subsequent events with significant financial consequences, indicating the extent of those consequences (DAS 640.414). These include events whose impact has not been recognised in the financial statements. See paragraph 2.7.

41.2.3 The balance sheet with notes

41.2.3.1 General

The special nature of foundations and associations is reflected on the balance sheet particularly in the presentation of equity. This only applies to the company-only balance sheet. In the consolidated balance sheet, equity need not be broken down. If equity is not broken down in the consolidated balance sheet, only any non-controlling interest is presented separately, as part of group equity (DAS 640.318). Differences between the amount of group equity in the consolidated balance sheet and the amount of equity in the company-only balance sheet must be disclosed (DAS 640.403).

Differences between company-only and consolidated equity
Consolidated financial statements constitute separate financial statements (Article 2:361(1) NCC). If there are differences between equity (and profit or loss) according to the company-only and consolidated financial statements, these must be disclosed in the notes to the company-only financial statements (Article 2:389(10) NCC). A common reason for differences between company-only and consolidated equity in foundations and associations is that the consolidating head of the group (the parent) does not have an equity interest in consolidated (subsidiary) foundations or associations. The equity of those consolidated subsidiaries is then of course included in the consolidated equity, but not in the parent's company-only equity. See also paragraph 41.3 on consolidation. To qualify as a participating interest, the element of capital contribution is essential. If there is no participating interest in the issued capital of an entity, there is not a participating interest in that entity (see paragraph 9.1). This is pre-eminently the case with foundations and associations. Since foundations and associations have no issued capital, there can be no participating interests in a foundation or association. However, foundations and associations can hold a participating interest in an entity with issued capital, such as a public limited liability entity or private limited liability entity.

41.2.3.2 Equity

Definition
Equity is the remaining interest in the assets of a foundation or association after deducting liabilities. Thus, the size of equity can only be determined indirectly, namely by determining the amount of assets and the amount of liabilities.

The equity of a foundation or association is special in nature. In general, equity is not intended to be distributed to the owners of the foundation or association at any time, as in the case of a company, but can only be used in accordance with the objectives for which the foundation or association was created. More specifically, pursuant to Article 2:285(3) NCC and Article 2:26(3) NCC, respectively, a foundation and association are not allowed to make distributions to founders or members of the foundation or association or to those who are part of its bodies (DAS 640.310).

Presentation on the balance sheet
On the balance sheet or in notes of the financial statements of a foundation or association, equity should be presented in such a way that it shows which part is freely disposable and which part is committed in some way (DAS 640.311).

Capital
In the case of a foundation, it does happen that initial capital is contributed at the time of establishment of the foundation. This part of equity is preferably referred to as 'capital' or 'foundation capital' (DAS 640.312).

Statutory reserves
If the articles of association provide that certain reserves with restricted spending options are formed, the amount and nature of these provisions should be disclosed in the notes (DAS 640.406).

Statutory reserves must be maintained in accordance with the relevant provisions contained in those articles of association until such time as the articles of association are amended. With any such amendment to the articles of association, the reason for recognising the statutory reserve disappears. A reserve so released by amendment to the articles of association may be added to the free reserves or to appropriated reserves. If the amount of statutory reserves exceeds the total amount of reserves, the difference is charged to free reserves. This then results in the statutory reserves having the amount to be held and the free reserves showing a negative amount (DAS 240.233).

Appropriated funds
If part of the equity has been ring-fenced because it has been given a more restricted spending option than would be permissible given the objective of the foundation or association and this restriction has been imposed by third parties, this part must be classified as appropriated fund (DAS 640.315). The notes must disclose the amount and restricted objective of each appropriated fund, the reason for this restriction and any other conditions imposed by the third parties (DAS 640.404).

Example: Presentation of appropriated fund

The Our Church Foundation owns a neo-Gothic church building and has the objective to preserve it. To this end, the church building is used for exhibitions, (classical) concerts and occasional events, such as company presentations and meetings.

The church building needs urgent restoration. A sum of 10,000 is budgeted to be needed for the restoration. The management board decides to create a 'restoration fund' for this purpose and opens a separate bank account for this purpose. A campaign will be set up to obtain donations from companies and individuals, who will deposit their donation in that bank account. Donations are made on the explicit condition that they are spent on restoration. The implementation of the restoration is expected to extend the useful life of the church building to 40 years. Donations of 9,500 are raised, which are received entirely in year 1. During year 2, the restoration will be carried out at a cost of 10,200. On 1 January of year 3, the restored church building is inaugurated. The residual value after 40 years is zero.

This is recognised in the financial statements as follows:

Year 1: Donations of 9,500 are recognised as revenues. This creates a positive operating balance in year 1. When this balance is appropriated, 9,500 will be added to the appropriated fund (restoration fund).

Year 2: The expenditure of 10,200 is capitalised. No amounts appear in the statement of income and expenses and there are no movements in the restoration fund.

Year 3: Based on straight-line depreciation, an amount of 255 (= 10,200 / 40) is charged to the statement of income and expenses as depreciation costs. When the profit or loss for year 3 is appropriated, this amount is withdrawn from the appropriated fund (restoration fund). The balance of the restoration fund after year 3 is then 9,245. After 38 years, (more than) 9,500 has been written off and the restoration fund balance is zero.

Appropriated reserves
If the restriction on the spending of equity has not been made by third parties but by the management board, the part of equity so segregated should not be referred to as an appropriated fund but as an appropriated reserve (DAS 640.313). The notes should disclose the amount and limited objective of each appropriated reserve and the fact that the management board has made this restriction (DAS 640.405).

The reason for the distinction between appropriated fund and appropriated reserve lies in the fact that in the latter case, it is the management board (and not a third party) that made the restriction on the spending. The management board can also remove that restriction again. Essentially, therefore, an appropriated reserve is still freely disposable equity.

The above applies accordingly even if the restriction is made by the members’ meeting of an association.

Revaluation reserve
If tangible fixed assets for own use are measured at current value, we believe that foundations and associations should recognise value increases directly in a revaluation reserve. This also applies to other assets that are measured at current value and for which the foundation or association uses accounting policies in which value increases are not immediately recognised as income. For assets measured at current value where value increases are recognised immediately as profit or loss, such as investment properties, the value increases are also recognised in a revaluation reserve unless frequent market quotations exist for these assets. This is because a revaluation reserve provides insight into the portion of equity caused by unrealised value increases. Furthermore, this is in line with the legislative text contained in DAS 240.222 (Article 2:390(1) NCC) and by the authoritative statement on revaluation reserves in investment property (DAS 213.504; see paragraph 8.3.4).

Revaluation reserves are recognised and held on an asset-by-asset basis. If the current value of an asset falls below its original purchase or manufacturing/construction cost (net of depreciation), the write-down will be charged to the statement of income and expenses. Any netting within the revaluation reserve item is therefore not allowed. Any distinguishable individual asset should be deemed an asset. This means, for example, that the revaluation reserve must be recognised for each distinguishable building. The creation of a deferred tax liability in conjunction with a revaluation is not mandatory. However, the recognition of a deferred tax liability is strongly preferred for foundations and associations subject to corporation income tax (DAS 272.304). See also paragraph 14.3.7.6.

Reserve for participating interests
In our opinion, foundations and associations may consider maintaining a reserve for participating interests when measuring participating interests using the net asset value method (see paragraphs 9.2.6 and 14.3.8). Maintaining that reserve in fact shows the share of profit from participating interests that the foundation or association has recognised in its statement of income and expenses, but the distribution of which it cannot effect without restriction.

Other (free) reserves
Other (free) reserves refer to freely disposable reserves, i.e. the part of the equity that the authorised bodies can dispose of without being impeded by statutory provisions or legal provisions for the purpose for which the foundation or association was established. This part of equity is preferably referred to as 'general reserve' or 'other reserve' (DAS 640.314).

The revaluation reserve and the reserve for participating interests can be presented as separate items or as part of other reserves.

Undistributed profit or loss
The last item of equity is the undistributed profit or loss in a balance sheet before appropriation of profit or loss. The balance sheet may reflect the equity taking into account the appropriation of the profit or loss or the proposal to do so (Article 2:362(2) NCC). The Decree on annual accounts format prescribes that, at the top of the balance sheet, it must be clear whether or not the appropriation of the profit or loss is recognised on the balance sheet. If the allocation of the profit or loss is not recognised on the balance sheet, the profit or loss is shown separately as the last item of equity.

Direct movements in equity
Foundations and associations should recognise all income and expenses in the statement of income and expenses with the exception of the direct movements in equity mentioned in DAS 240 'Equity' (DAS 640.201). The essence of the provisions in DAS 240 'Equity' is that almost exclusively changes in equity that relate to the direct financial relationship of the foundation or association with its members (in the case of an association) and movements in legal reserves are recognised directly in equity. Almost all other movements in equity are recognised in the statement of income and expenses. In determining the amounts to be credited or charged directly to equity, account is taken of related changes in tax payable or in the provision for deferred taxes, respectively, if applicable. These changes should also be credited or charged directly to equity (DAS 240.402).

Examples of equity movements that concern an association's financial relationship with its members as such and that may be relevant for associations and are recognised directly in equity are (DAS 240.403):

- equity increase and settlement of losses (including debt cancellation); and
- equity decrease through repayment of contributed capital.

Notes
In the notes, equity should be presented in a way that shows which part is freely disposable and which part is restricted in some way. It is also possible to present it as such on the balance sheet (DAS 640.311).

A movement schedule should be included in the notes for each equity item (DAS 640.317). The movement schedule forms part of the notes to the company-only financial statements. Comparative figures are presented with the movement schedule (DAS 240.237). The consolidated financial statements, being the financial statements of the group, need not include an equity movement schedule. Nor is it necessary to break down equity in the consolidated financial statements. This breakdown is only prescribed in the company-only financial statements (Articles 2:410(1) and 411(1) NCC / DAS 640.318).

Significant movements in equity after the end of the financial year are disclosed in the notes (DAS 240.242).

41.2.4 Statement of income and expenses with notes

41.2.4.1 Definitions

Income and expenses
It is recommended that foundations and associations replace the term 'profit and loss account' with the term 'statement of income and expenses'. Other names that better reflect the nature of this statement are also acceptable (DAS 640.302), e.g. 'operating account'. The statement of income and expenses is, of course, about income and expenses. Although these terms have already been elaborated in Chapter 2, their definitions are set out again below.

Income refers to growth in economic potential during the reporting period in the form of inflows of new assets or increases in existing assets, or reductions in liabilities, resulting in increases in equity, other than through contributions from participants therein. Expenses are reductions in economic potential during the reporting period in the form of outflows or depletion of assets, or the creation of liabilities, resulting in a decrease in equity other than through distribution to participants therein. This shows the close relationship that exists between the recognition of income and expenses and the recognition of assets and liabilities. If the criteria for recognising (or derecognising) an asset or liability as mentioned in Chapter 2 are met, then the criteria for simultaneously recognising the associated income or expenses are also met.

All income and expenses should be recognised in the statement of income and expenses, except for the permitted direct movements in equity mentioned in paragraphs 41.2.3.2 and 14.4. Expenditure covered by appropriated reserves and appropriated funds must also be recognised in the statement of income and expenses (DAS 640.201). The same applies to appropriated income and expenses (DAS 640.207). Income for which a special destination is appropriated is disclosed separately in the notes to the statement of income and expenses (DAS 640.408).

41.2.4.2 Basis of the statement of income and expenses

General
To provide the required insight, the statement of income and expenses with notes must give a true, fair, clear and consistent view of the amount of profit or loss for the financial year and of the composition of the income and expenses. Receipts and expenditures are allocated in the statement of income and expenses to the period to which they relate. This involves taking into account the amounts to be allocated to a period which have been or will be received or paid in another period. Therefore, in the majority of cases, a transaction or event is recognised before its financial settlement. Consistent practice should be followed when allocating these amounts.

Including budget figures in the statement of income and expenses
An important provision for all not-for-profit organisations is that the statement of income and expenses must include the budget figures for the financial year, in addition to the comparative figures for the previous financial year (DAS 640.305). Differences between budget and actual figures should also be analysed in the notes (DAS 640.402). Budget figures and variance analysis are not included if this is not useful given the function assigned to the budget by the foundation or association. The latter is the case, for example, if the foundation or association does not use the budget as an important steering tool for controlling activities. The same provisions apply to whether or not to include budget figures for the year following the reporting period in the management board report. See paragraph 41.5. In practice, it will not always be clear whether or not the budget is used as an important steering tool and whether or not it is justified to omit the budget figures. This requires consideration by the management board of the foundation or association.

Timing of recognition
A transaction or event is recognised at the time it occurs. The timing of recognition of income and expenses is discussed in Chapter 26 and paragraph 23.3 respectively. Those chapters refer to 'revenues'. For foundations and associations, this should read 'income'. In principle, income is recognised for each individual transaction.

41.2.4.3 Amount of the income

General
The amount of income is the amount to which a foundation or association expects to be entitled in exchange for transferring promised goods or services (DAS 270.106). This amount is referred to as 'transaction price'. Often, the transaction price can be determined on the basis of the contract concluded between the foundation or association and the other party, which specifies what the consideration consists of, namely the cash to be paid to the foundation or association. See also paragraph 26.4.

When recognising income, it is important that this income is also received for one's own account. This means that amounts received by the foundation or association for third parties are not recognised as income.

Example: Amounts received for third parties

Municipality A provides annual grants to dozens of sports associations based in the municipality. The implementation and administration of these grants on behalf of the municipality has been assigned to the Foundation for Sports Grants in Municipality A. This foundation assesses the applications and makes the commitment for these grants to the sports associations on behalf of the municipality. The municipality pays all grants to the foundation, which distributes them to the relevant sports associations. A small part of the total grant amount, namely 1% of it, serves to cover implementation and administration costs and is not passed on to the sports associations. This 1% constitutes income for the foundation and is credited by the foundation to its statement of income and expenses. The remaining 99% was received by the foundation on behalf of third parties, namely the sports associations. This part is not included in the foundation's statement of income and expenses.

Income in kind
If income is received in the form of goods or services, it should be measured at fair value (to the extent that it can be reliably measured and is material) and recognised at that fair value in the statement of income and expenses (DAS 640.204). This is the case, for example, when tangible fixed assets are acquired for an amount lower than the fair value of those assets or 'for no consideration'. If significant income in the form of goods or services cannot be reliably estimated, it should be disclosed in the notes (DAS 640.407).

Voluntary work is not recognised in the statement of income and expenses. If voluntary work is important to the foundation or association, it is reported in the management board report (DAS 640.204).

41.2.4.4 Classification

The profit and loss account models set out in Title 9 Book 2 NCC and the Decree on annual accounts format are prescribed only for public and private limited liability entities. The models included in the Decree on annual accounts format are applied to a foundation or association only insofar as this provides a good insight into the particular characteristic of the foundation or association in question. In order to provide this insight, descriptions of and classifications in items are adjusted as necessary (DAS 640.307). When presenting the statement of income and expenses, a choice should be made between the model by nature of expense and the model by function (DAS 640.308). Income for which a special purpose is appropriated should be disclosed separately in the notes to the statement of income and expenses (DAS 640.408).

Model by nature of expense
In the model by nature of expense, where applicable, at least the following categories of income and expenses should be distinguished (DAS 640.309):

Income
- income in return for the supply of products and/or services;
- grant income;
- sponsorship contributions;
- donations and income from fundraising;
- financial income;
- other income.

Expenses
- purchase value of products delivered;
- personnel costs;
- depreciation of fixed assets;
- grants or donations provided;
- financial expenses;
- other expenses.

Model by function
The manner in which costs are allocated to activities should be disclosed in the notes (DAS 640.412).

Exceptional income and expenses
DAS 640 contains no specific provisions for the presentation and disclosure of exceptional income and expenses in the statement of income and expenses. DAS 270.4 does include such provisions. Under DAS 640.102, the relevant provisions also apply to foundations and associations. See paragraph 23.7.

41.2.4.5 Profit or loss and appropriation of profit or loss.

The profit or loss must be presented before recognition of withdrawals from or additions to the appropriated funds or appropriated reserves (see paragraph 41.2.3.2). If income for which a special destination has been appropriated has not been fully spent in the reporting period, the foundation or association must add the amounts not yet spent to the appropriated reserves or appropriated funds respectively via the appropriation of income (DAS 640.205). If the foundation or association draws from these appropriated reserves or appropriated funds in a subsequent reporting period, the expenditure must be recognised through the appropriation of profit or loss as a withdrawal from the appropriated reserves or appropriated funds respectively (DAS 640.206).

Foundations and associations include the appropriation of profit or loss under the statement of income and expenses. Additions to and withdrawals from appropriated reserves and appropriated funds are presented as separate items in the appropriation of income (DAS 640.306).

Example: Appropriation of profit or loss

Foundation A achieved an operating loss of 125,000 for year 2 (year 1: 85,000 positive), while a negative balance of 15,000 was budgeted. For the implementation of project ABC, as part of its programme of activities, the foundation created an appropriated reserve of 30,000 in year 1, from which 30,000 was withdrawn in year 2 in connection with the implementation of project ABC in that year. As the original plan was for the relevant work to be carried out in year 3, these costs were not included in the budget for year 2. In addition, a restructuring was carried out in year 2 for which an appropriated reserve had been created when the operating profit for year 1 was appropriated. The statement of income and expenses includes a breakdown of the appropriation of the operating income:

Statement of income and expenses for year 2	Realisation year 2	Budget year 2	Realisation year 1
Profit or loss	(125,000)	(15,000)	85,000
Appropriation of profit or loss:			
Added to (withdrawn from) appropriated reserve for maintenance	(30,000)	0	30,000
Added to (withdrawn from) appropriated reserve for restructuring	(40,000)	(40,000)	40,000
Added to (withdrawn from) the other reserves	(55,000)	25,000	15,000
	(125,000)	(15,000)	85,000

41.2.4.6 Specific items of the statement of income and expenses

This paragraph details the principal specific items of the statement of income and expenses.

Income in return for the supply of products and/or services
Income in return for the supply of products and/or services is presented in the statement of income and expenses as net revenue. This can also be referred to by a more specific description, such as subscription fees, members' contributions or rental income (DAS 640.319). The definition of net revenue is contained in Article 2:377(6) NCC. Net revenue is defined as the revenue from the goods supplied and services rendered by a foundation or association less discounts etc., and taxes levied on revenue (such as VAT). This means that net revenue reflects the foundation's or association's volume of business, i.e. what it generates for its own account and risk by selling and delivering (or transferring ownership) or by providing services to its customers. Amounts that a foundation or association receives for third parties are not increases in economic potential and do not increase equity. Therefore, it does not recognise such amounts as revenue (DAS 270.105c). The term net revenue should be interpreted from the perspective of ordinary, recurring operating activities (DAS 270.201).

The above also implies that grant income and contributions or donations are not included in net revenue, unless they are received in return for products and/or services provided for its own account and risk to the funder (grant provider) as customer. If performance to the funder as a customer is delivered from the business of the foundation or association, however, this will constitute net revenue. This is particularly relevant when interpreting the net revenue criterion for determining whether the foundation or association is a commercial foundation or association. See Chapter 41.

All foundations and associations (i.e. also foundations and associations that do not qualify as commercial foundations or associations) that run a business that must be registered in the Trade Register, must disclose the net revenue of the business in the operating account or in the statement of income and expenses (Article 2:48(3) and Article 2:299a NCC respectively). The aim is to be able to determine whether the foundation or association is subject to the financial statement obligations of Title 9 Book 2 NCC. This is covered in detail in Chapter 40.

Income from sponsoring
Income received from another party (sponsor) in the form of money, materials or services, in return for which the foundation or association provides a defined compensation, whether equivalent or not, is referred to as income from

sponsoring (DAS 640.0). Income from sponsoring must be presented or disclosed separately in the statement of income and expenses (DAS 640.309).

Grant income

Foundations and associations sometimes receive grants that are made conditional by the provider on the cost of implementing or investing in a project or on the operating deficit of the entire organisation, or depend on a performance delivered by the organisation. Examples of common grants are (DAS 640.204a):

- performance grants, for example for scientific research;
- investment grants, e.g. contributions towards the overall construction costs of a building; and
- operating grants, e.g. contributions towards an operating deficit of an association or institution.

For the recognition, measurement and presentation of grant income, DAS 274 'Government grants and other forms of government assistance' should be applied to the extent possible (DAS 640.204b). See Chapter 29.

Grants can be obtained from different categories of grant providers (DAS 640.409). These can be governments, such as the EU, the central government, provinces and municipalities. However, they could also be other organisations or companies. If different types of grants and/or grants from different categories of grant providers are obtained, the (notes to the) statement of income and expenses should disclose the grants obtained separately by main group (DAS 640.409). Different categories concern both governments (EU, Central Government, provinces, municipalities) and others (companies and other organisations). The notes should also show whether the grants in question are of an incidental or structural nature (DAS 640.409).

The purpose of this presentation is to enable users of the financial statements to form an opinion about the extent to which revenue is incidental or permanent. From this, insight can be gained into the risks that the foundation or association faces with regard to future expected revenues (DAS 640.410).

The notes should include any grant conditions. They should also state to what extent grant payments have not yet been approved by the grant provider (DAS 640.411).

The following must also be disclosed in the notes to the financial statements (DAS 274.121):

- the nature of government grants and other forms of government assistance obtained;
- how government grants and other forms of government assistance have been recognised in the financial statements;
- the extent of the government grants and other forms of government assistance recognised in the reporting period;
- the contingent financial liabilities related to development loans received.

The disclosure requirements referred to above generally apply to all forms of (government) grants and (other forms of) government assistance.

If the grant is designated as an operating grant, the following method of presentation in the financial statements applies (DAS 274.111):

- under revenues, under a general item such as 'other revenues' or as a separate item; or
- under costs, deducted from grant-related costs.

The method of presentation should take into account the nature of the operating grant. Here, a distinction is made between:

- grants for spending; and
- grants obtained for certain revenue losses or for operating deficits in general.

Grants for spending can be presented using either presentation method. Grants for certain revenue losses or for operating deficits in general are presented under revenue. The first presentation method makes it easier to understand the gross amounts of related costs. The second method underlines the fact that some of the costs might not have been incurred if the grant had not been available. Another argument for this method is that the grant received should be used to pay those costs. See also paragraph 29.3.2 for the measurement and presentation of operating grants.

Contributions from members and/or donors
Contributions from members and/or donors are disclosed separately as a revenue category along with, for example, the description 'contributions' or 'donations', unless they are in the nature of consideration for the provision of specific products and/or services (DAS 640.320).

Income from inheritances
Income from inheritances should be recognised in the financial year in which the income can be reliably determined. Income from an inheritance can be reliably determined if, based on the stage of the settlement of the inheritance, a reliable estimate of the final (financial) size of the inheritance can be made. This assessment takes place on a per inheritance basis. The time at which the (financial) size of the inheritance can be reliably determined is assessed for each inheritance (DAS 640.208).

As an alternative to assessment on a per inheritance basis, it is acceptable to recognise income from inheritances at the time when the deed of distribution, or if there is no deed of distribution, the accountability report, is received. Under this alternative, the benefit from the inheritance is recognised only if the deed of distribution or the accountability report was received before the reporting date (DAS 640.208). Upon receipt of the deed of distribution or accountability report after the reporting date, disclosure is made in the notes (it then concerns 'contingent assets', see paragraph 20.2). If the alternative recognition method is chosen, the organisation should recognise income from all inheritances in this manner.

Under both recognition methods, an advance received before the size of the inheritance can be reliably determined, or the deed of distribution or the accountability report is received, is recognised as income from an inheritance in the financial year in which the advance is received (DAS 640.208). Although these disbursements are formally provisional, according to the DAS, in practice advances are rarely paid that are later recovered by the executor.

The recognition method chosen must be disclosed in the notes (DAS 640.208).

Inheritances should be measured at fair value at initial recognition. When measuring, the foundation or association should take into account any rights of usufruct rights (DAS 640.208). For the measurement of property, the foundation or association may use the last available WOZ value. To measure the usufruct, the foundation or association may use the tax value of the usufruct (DAS 640.208).

Income from own lotteries
Income from own lotteries should be recognised for the total amount of the stake plus the value of the prizes obtained for no consideration and less the value of the prizes provided (DAS 640.209).

Grants or donations provided
Grant obligations and obligations to make donations should be recognised in the statement of income and expenses at the time the obligation is incurred, even if the obligation is incurred for more than one year (DAS 640.202). A grant obligation or obligation to make donations usually only exists after the competent body has made a decision on the matter and communicated it in writing to the recipient of the grant or donation, such that a legal or constructive obligation arises (see also paragraph 19.1).

Grant commitments can be unconditional or conditional. Unconditional grant commitments should be recognised at the time the commitment is made. However, it is also common in practice for a foundation to make a conditional grant commitment. An example is if a foundation has included in the contract the condition that the grant obligations under the agreement will only take effect once the foundation has found its own funding for this specific project (suspensive condition). This grant commitment is initially disclosed as an off-balance-sheet liability. Once the event has occurred on the basis of which the suspensive condition is met, the grant commitment is recognised in the statement of income and expenses.

Another example is when a foundation enters into a grant commitment with another party for the realisation of a project where disbursement is made in tranches depending on the achievement of project milestones. The foundation can dissolve the contract at any time in the interim (resolutive condition) if the other party fails to meet the grant conditions. The foundation recognises the grant commitment in the statement of income and expenses to the extent that the commitment is unconditional. In other words, if the foundation has made the first tranche payable because the other party has complied with the specified conditions, an expense is recognised for this tranche in the statement of income and expenses and a liability on the balance sheet. If grant obligations lapse, they must be visibly deducted from the grants or donations provided in the notes to the statement of income and expenses in the financial year in which they lapse (DAS 640.203).

Financial income and expenses
In general, interest is considered the principal financial income or expense. Chapter 27 discusses the recognition of borrowing costs in more detail. Other items that may be included under financial income and expenses are profits and losses of and dividends from participating interests. For this, see Chapter 9.

All income and expenses should be recognised in the statement of income and expenses (DAS 640.201). Therefore, any interest income from invested equity outside the statement of income and expenses may not be added to equity.

41.2.4.7 Remuneration of management board members and supervisory board members

Required disclosures - general
The remuneration including pension costs of current and former management board members and current and former supervisory board members should be disclosed by category (DAS 640.413). This refers to the remuneration charged to the foundation or association during the financial year. For a detailed description of the term 'remuneration', please refer to paragraph 18.8.

If consolidated financial statements are prepared (see paragraph 41.3), remuneration of management and supervisory board members of the consolidating foundation or association is disclosed on a consolidated basis. This means that amounts charged to consolidated group companies and other entities are included in the disclosure (DAS 640.413).

Disclosure of the remuneration of management board members and supervisory board members for a foundation or association may be subject to the disclosure requirements of the Standards of Remuneration Act. See paragraph 41.2.4.8.

The amounts of loans, advances and guarantees granted to current and former management board members and current and former supervisory board members must also be disclosed (DAS 640.413). The disclosure includes amounts outstanding, amounts written down and amounts waived, interest rate, principal other provisions and repayments during the financial year (Article 2:383(2) NCC).

Exemption for disclosures traceable to a single natural person
Information on remuneration need not be disclosed if the amount can be traced to a single natural person (DAS 640.413).

Further explanation of required disclosures
Any amounts received from consolidated companies by current and former management board members and by current and former supervisory board members that have subsequently been remitted to the foundation or association are no longer charged to income and are therefore disregarded in the determination of the amounts referred to (DAS 271.603).

If a supervisory board member's work entails issuing opinions to the extent that significantly exceeds the workload usually associated with supervision and is otherwise performed by third parties, the fees for such additional work need not be recognised as remuneration (DAS 271.604).

The required disclosure of information on the remuneration etc. of current and former management board members and of current and former supervisory board members may be made in the notes to the company-only financial statements and in the notes to the consolidated financial statements. Given the purport of this requirement, disclosing the said information solely in the notes to the consolidated financial statements is considered sufficient (DAS 271.605).

41.2.4.8 Remuneration of senior executives in the public and semipublic sectors

General
The Standards of Remuneration Act (*Wet normering topinkomens*, WNT) imposes requirements on disclosure in the financial statements by entities and institutions in the public and semipublic sectors of remuneration paid to senior executives and other executives. If a foundation or association comes under the scope of the WNT, the disclosure requirements provided by the WNT apply. For the terms used in this paragraph, please refer to Article 1.1 of the WNT.

Scope
The WNT applies to entities governed by private law:

- that have a body vested with public authority;
- whose management board members are appointed by a public body or entity governed by public law, or where significant influence over management or policy is otherwise exercised by a public body or entity governed by public law, with the exception of public limited liability entities and private limited liability entities, whose shares are held by a public body;
- that are specifically referred to in the annexes to the WNT; and
- that, for at least three consecutive calendar years, have received grants (as referred to in the General Administrative Law Act (*Algemene wet bestuursrecht*, 'Awb') which together exceed EUR 500,000 annually and account for at least 50% of the entity's annual income, with the exception of public limited liability entities and private limited liability entities that operate for profit.

If an entity comes under the scope of the WNT, the disclosure requirements provided by the WNT apply. In that case, that entity need not include the disclosures of remuneration of management board and supervisory board members discussed in paragraph 18.8 (Article 4.2 WNT).

The WNT pertains to the calendar year. This means that the WNT disclosure of an entity with a broken financial year refers to the calendar year preceding the year in which the financial year ends. So if the financial year ends on 30 June of year t+1, the WNT disclosure refers to calendar year t. In addition, comparative data should be included for calendar year t-1.

Required disclosures for senior executives
Details of the following senior executives must be disclosed in the notes as mentioned in the WNT Implementation Regulations:

- of each senior executive whose total remuneration exceeds EUR 1,900: the details listed in Article 5(1) of the WNT Implementation Regulations;
- of each senior executive whose total remuneration is EUR 1,900 or less: the details listed in Article 5(3) of the WNT Implementation Regulations;
- of each senior executive whose total remuneration exceeds EUR 1,900 and who holds a position other than based on an employment relationship: for the period of job performance up to and including 12 months, the details listed in Article 5(4) of the WNT Implementation Regulations;
- of each senior executive who has received a severance payment: the details listed in Article 5(5) of the WNT Implementation Regulations; and
- of each senior executive whose remuneration exceeds the maximum permitted remuneration or if the severance payments exceed the maximum permitted payment: the details listed in Article 5(6) of the WNT Implementation Regulations.

Required disclosures for other employees
For each employee other than a senior executive whose remuneration exceeds the maximum remuneration, the details listed in Article 5a(1) of the WNT Implementation Regulations are provided.

The notes to the financial statements must include a justification for the fact that the remuneration exceeds the maximum remuneration (Article 5a(4) WNT Implementation Regulations).

Notes in the company-only or consolidated financial statements
The required disclosure of information on remuneration under the WNT may be made in the notes to the company-only financial statements or in the notes to the consolidated financial statements. Disclosure may also be made in the

notes to the company-only financial statements of one of the other entities in the group, to the extent permitted by other regulations applicable to the entities. Merely mentioning said data in the notes to the consolidated financial statements or in the company-only financial statements of one of the other entities in the group is sufficient if (Article 5c(3) of the WNT Implementation Regulations):

- the consolidated financial statements or the company-only financial statements of one of the other entities in the group indicate, for each executive and for each employment relationship, to which entity or entities the recognised WNT details relate; and
- the financial statements of the relevant entity refer to the consolidated financial statements or the company-only financial statements of one of the other entities in the group in which the WNT recognition is included.

41.2.5 Specific provisions of Title 9 Book 2 NCC

For a number of legal provisions of Title 9 Book 2 NCC, the question is to what extent they are relevant to foundations and associations. This paragraph addresses the following provisions:

- the immediate action to be taken if the financial statements are seriously deficient;
- stating the average number of employees;
- disclosing related party transactions;
- disclosing audit fees; and
- providing information on off-balance-sheet arrangements.

Immediate action if the financial statements are seriously deficient
If adopted financial statements are found to be seriously deficient, the question is whether rectification only takes place in the subsequent financial statements, or whether immediate action is also necessary or desirable with regard to the already adopted (erroneous) financial statements. In our opinion, it is recommended that the management board should then immediately notify the members (of the association) or the body responsible for adopting the financial statements (of the foundation) that the adopted financial statements are seriously deficient in providing the required insight. If these financial statements have been made public, it is advisable to make that communication public in the same way. If these financial statements have been audited by an auditor, it is also recommended that an auditor's report (audit opinion) also accompany this communication. Thereby providing information relevant to users of the financial statements. In addition, this may be important for any liability of management board and supervisory board members. These recommendations are in line with what is regulated by law for entities governed by Title 9 Book 2 NCC.

Disclosing the average number of employees
Foundations and associations may consider disclosing the (average) number of employees in the financial statements. This means the number of employees with whom an employment contract has been entered into.

Disclosing of related party transactions
When perusing a foundation's or association's financial statements, it is important to know whether the foundation or association is entirely independent or whether it is in relation to certain related parties. In the latter case, related parties and related party transactions must be disclosed in the financial statements in certain cases. For entities falling under Title 9 Book 2 NCC, this is regulated in Article 2:381(3) NCC for material transactions with related parties not entered into under normal market conditions. In addition, the Dutch Accounting Standards Board recommends that material transactions entered into under normal market conditions should also be disclosed (DAS 330.201). See paragraph 30.3.

Disclosing audit fees
The legal obligation to disclose audit fees stems from the implementation of Directive 2006/43/EC in Dutch law. According to the EC directive, the purpose of this disclosure is: 'to render the relationship between the (legal) auditor or audit firm and the audited entity more transparent'. To assess the independence of the auditor, foundations and associations may consider providing information on the fees of the relevant audit firm. See paragraph 30.7.

Off-balance-sheet arrangements
Off-balance-sheet arrangements may affect the financial position of the foundation or association because they may involve risks or benefits for the foundation or association. For this reason, we believe that foundations and

associations should include information on these arrangements in the notes to the financial statements. Entities governed by Title 9 Book 2 NCC are required by law to include this information. See paragraph 30.8.

41.2.6 Recognition of shares held by a Trust Foundation

Description of a Trust Foundation
A Trust Foundation (Stichting Administratiekantoor) usually has as its general objective the ownership, management and administration of shares against the granting of share certificates. Resulting from this objective, a Trust Foundation performs the duties relating to the rights attached to the administered shares, such as voting rights and claim rights. A Trust Foundation also handles the onward payment of dividends received and other distributions to the share certificate holders.

Recognition of shares and share certificates held
The question is how to recognise shares held by a Trust Foundation. The Dutch Accounting Standards Board has included provisions on this. Under the trust conditions, a Trust Foundation almost never has beneficial ownership of the shares. This is because a Trust Foundation is not entitled to the economic benefits of the shares. Furthermore, a Trust Foundation is also not at risk with regard to these shares. On this basis, such shares do not constitute assets of a Trust Foundation. At the same time, under the trust conditions, a Trust Foundation almost never has any obligations towards the share certificate holders. Only when benefits associated with the shares become available (including the receipt of dividends), an obligation arises for a Trust Foundation to distribute them to the share certificate holders. On this basis, the Dutch Accounting Standards Board argues that the shares should not be recognised as assets on the balance sheet of a Trust Foundation. Furthermore, no liability is recognised on the balance sheet for the share certificates issued (DAS 640.524). Receipts on shares and distributions on share certificates are not recognised as income and expenses in this case (DAS 640.527). Alternatively, shares held in trust and share certificates issued are allowed to be recognised as memorandum item on the balance sheet (DAS 640.526).

Disclosure requirements
A Trust Foundation should include the following in the notes to the financial statements (DAS 640.529):

- the number and relative interest of shares held in trust of the relevant entity;
- the rights associated with these shares;
- the number and relative interest of the share certificates issued;
- the certification conditions and the possibility of conversion; and
- the receipts on shares and distributions on share certificates.

41.3 Consolidation

41.3.1 General

Introduction
Chapter 33 deals with the consolidated financial statements and addresses the consolidation obligation and consolidation scope of entities based on Title 9 Book 2 NCC and DAS 217 'Consolidation'. Chapter 33 also applies to foundations and associations. A foundation or association that heads its group prepares consolidated financial statements that include its own financial data along with those of its group entities and other entities over which it can exercise control or of which it conducts the central management (DAS 640.501). The head of the group is the foundation or association that conducts the central management of the group and can determine group policy (DAS 640.505). In case of foundations and associations, there is often no relationship between organisations through share ownership. This paragraph deals with additional aspects to be considered when assessing whether there is a group relationship between foundations and associations.

Power to determine policy
What matters is whether a foundation or association has the power to determine policy at another organisation. This is the case if (DAS 640.501):

- the other organisation's financial and operational policies can be determined; and
- based on this, significant economic benefits can be achieved and also significant economic risks are incurred in relation to the activities of the other organisation.

In case of foundations and associations, there is often no relationship between organisations through share ownership. The relationship between these organisations is then based in particular on the provisions contained in the articles of association and contractual provisions regarding influence on policy and economic benefits and risks related to the activities. All these provisions are considered in order to assess in the specific situation whether a group relationship exists. In itself, unity of management of two organisations is an insufficient basis to conclude that a group or group relationship exists (DAS 640.501).

Indications of a group relationship
The actual determination of whether there is power to determine policy and therefore a group relationship is not straightforward in certain situations. Aspects relating to the influence on the policy of the other organisation that are relevant in the assessment, among others (DAS 640.502):

- whether or not it holds the majority of voting rights in the management board or equivalent management body of the other organisation; or the ability to otherwise exercise decisive influence on such voting rights;
- the ability or inability to appoint or dismiss the majority of the members of the management board or equivalent management body of the other organisation;
- the ability or inability to exercise the majority of voting rights in the general meeting of the other organisation or the ability to influence voting behaviour;
- whether or not it has a right of veto over major decisions of the management board or equivalent management body of that other organisation or the ability to revoke or amend such decisions; for example on operational decisions or with regard to investment budgets;
- being authorised or not authorised to approve the appointment, reappointment and dismissal of key officials in the other organisation;
- whether the mandate of the other organisation is defined and limited;
- having or not having special control rights by virtue of which influence can be exercised on the financial and operational policy of the other organisation.

For foundations and associations, it is common for a management board to function and a supervisory board to oversee the management board's work and also exert decisive influence on decision-making. The supervisory board can then be regarded as an example of an 'equivalent management body' referred to above.

Aspects relating to the economic benefits and risks associated with the activities that are important in the assessment, among others (DAS 640.503):

- whether or not it has the power to dissolve the other organisation and obtain a substantial share of the remaining economic benefits or bear substantial debts;
- having or not having the power to withdraw distributions of assets from the other organisation, and/or being liable for certain obligations of the other organisation;
- holding, directly or indirectly, title to the equity of the other organisation with a right to dispose of it on a continuous basis;
- being entitled to a substantial part of the other organisation's equity in a given situation, for example in case that the other organisation is dissolved;
- the ability to give directions to the other organisation to cooperate in achieving its own objectives;
- being exposed or not to the other organisation's remaining debts.

If there is economic dependence on a particular organisation, this does not necessarily mean that that other organisation exercises control (DAS 640.504). For example, in case a particular foundation receives most of its funds from another foundation. This recipient foundation itself has the authority to decide whether to accept funds from the donor foundation. In such a case, while the donor foundation has influence, it does not automatically have the power to determine financial and operational policies.

Other entities over which control may be exercised or of which the central management is conducted
These entities cover entities that are not group entities, but over which control may be exercised or of which the central management is conducted. An example is a special purpose entity (SPE). SPEs are usually set up to fulfil a special purpose and can take the form of an entity (private limited liability entity, foundation, etc). or of an unincorporated company (limited partnership, general partnership, trust, etc.). SPEs are entities in which only narrowly defined activities take place, such as debt collection or property management, usually for the exclusive benefit of one group. Often, although there is a clear relationship with the group, there are also restrictions under the

articles of association or organisational restrictions on control, meaning that one cannot simply speak of a group entity. In answering the question whether an SPE is included in the consolidation scope, it is irrelevant whether an SPE qualifies as a group entity. For DAS 640.501 stipulates that not only group entities must be consolidated, but also other entities over which control may be exercised or of which the central management is conducted. This addition refers to SPEs.

41.3.2 Particulars of consolidation obligation and consolidation of foundations and associations

Consolidation obligation in case of ancillary organisations
There is also a consolidation obligation in respect of group entities in which the reporting foundation or association does not have an equity interest. Such a situation can arise pre-eminently in foundations and associations. The determining factor is whether the (policy-dependent) organisation meets the criteria for being a group entity of the (policy-determining) foundation or association. It follows that in the case of ancillary organisations, whose management boards form a personal union, there may be a group relationship and therefore a consolidation obligation (DAS 640.506). In itself, unity of management (or a personal union) is an insufficient basis to conclude that a group or group relationship exists (DAS 640.501). See paragraph 41.3.1. Where no group relationship exists, there may be related parties, requiring disclosure of transactions between them. See paragraph 41.2.5.

Consolidation of foundations and associations
The head of the group may have to include foundations and/or associations in the consolidation. Since no equity interest in a foundation or association can be expressed in the group head's company-only balance sheet, elimination of such equity interest against the equity of the foundation or association is not possible. Consolidating financial statements of foundations and associations therefore comes down to merging the relevant financial statements, while eliminating intercompany receivables and debts and intercompany income and expenses (DAS 640.509). Group equity according to the consolidated financial statements therefore differs from the group head's equity according to the company-only financial statements. Such a difference must be disclosed in the company-only financial statements (Article 2:389(10) NCC).

No third-party interest may arise in the consolidation of foundations. The reason is that while a third party may have influence in a foundation, there is no participating interest in a financial sense. The third party has influence but no proprietary right. Therefore, in the case of such third-party influence, undistributed group equity may be recognised in the consolidated financial statements.

41.4 Recognition of mergers and acquisitions

41.4.1 Introduction

This paragraph complements Chapter 31 'Mergers and acquisitions'. Chapter 31 deals with the recognition of mergers and acquisitions by commercial companies. This paragraph deals specifically with the recognition of mergers and acquisitions by foundations and associations.

According to the Dutch Accounting Standards Board, an acquisition and a pooling of interests, involving the acquisition of an integrated set of activities, assets and/or liabilities capable of generating revenues, should be distinguished from the situation where an acquiring foundation or association acquires certain assets and/or liabilities against debt recognition or for no consideration. In that case, the definitions of an acquisition or pooling of interests are not met. Therefore, according to the Dutch Accounting Standards Board, this paragraph does not apply to the acquisition of assets and/or liabilities where there is no acquisition of an integrated set of activities, assets and/or liabilities capable of generating revenues (DAS 216.602).

With mergers of or acquisitions by foundations and associations, respectively, in many cases a transaction does not materialise based on the fair value of the acquired or merged activity. Since no shareholders are involved as stakeholders, there is often no interest in effecting the transaction on that basis. Rather, the objective is to merge the equities of both parties in order to deploy the combined assets and liabilities for the purpose of the new (merged) entity. Such transactions often take place based on carrying amounts or for no consideration (DAS 216.603).

41.4.2 Recognition method in case of a legal merger

A legal merger between foundations or associations (whether or not through the establishment of a new foundation or association) should be recognised as a pooling of interests (DAS 216.605). A pooling of interests is recognised using the pooling of interests method. Under this method, the combined assets and liabilities are, in principle, recognised at their carrying amount and (negative) goodwill is not at issue. This method is described in more detail in paragraph 31.4. This recognition method should also be followed (DAS 216.605):

- if no purchase price is paid by the acquiring foundation or association to the transferring entity and the merger is implemented by an asset/liability transaction in which two entities wish to continue their business activities jointly either in the acquiring foundation or association or in another entity;
- in the case of a legal merger of an acquiring foundation or association with a public or private limited liability entity, of which the foundation or association already owns all the shares; and
- in case of a legal merger of an acquiring foundation with an association of which it is the sole member.

41.4.3 Recognition method on payment of purchase price

If a merger or acquisition between foundations and associations is implemented by an asset/liability transaction (or corporate merger) in which a purchase price is paid by the acquiring foundation or association to the transferring entity, this merger or acquisition should be recognised as an acquisition in accordance with the recognition method of acquisitions between parties acting at arm's length (DAS 216.604). That recognition method is the 'purchase accounting' method. Under this method, the identifiable assets and liabilities acquired are measured at fair value on the acquisition date and any (negative) goodwill is reflected. For a description of this method, please refer to paragraph 31.3. Recognition of goodwill is discussed in Chapter 6.

41.4.4 Recognition method in case of acquisition of shares in a public or private limited liability entity

If a foundation or association acquires the shares of a public or private limited liability entity, it should be determined whether there is an acquisition or a pooling of interests. This should be determined on the basis of the provisions applicable for parties acting at arm's length (DAS 216.606). These provisions are contained in DAS 216.107, 108 and 110. Briefly, this entails that it usually concerns an acquisition. A pooling of interests only occurs when two equal parties combine their entire equity on an equal basis and control is also shared equally. When acquiring shares in a public or private limited liability entity, this will only be at issue in exceptional cases. See Chapter 31.2 for further details.

An acquisition must be recognised using the purchase accounting method. A pooling of interests must be recognised according to the pooling of interests method. The pooling of interests method is described in more detail in paragraph 31.4. The purchase accounting method is described in more detail in paragraph 31.3.

41.4.5 Mergers and acquisitions under common control

A transaction under common control exists if the same parties ultimately control the acquirer and the acquiree (or the merging parties), both before and after the acquisition (or merger). Control may not be temporary. Control may be exercised by entities as well as natural persons. Control may be exercised by several parties, which individually do not have control, but exercise it together through a contractual arrangement. For the recognition of mergers and acquisitions under common control, see paragraph 31.6.

41.4.6 Disclosure

For a description of the disclosures to be included in the financial statements in the case of a merger or acquisition, see paragraph 31.7.

41.5 Management board report

41.5.1 General

Introduction
The management board report of foundations and associations has special significance. For the nature of the activities entails that their social significance can only be reflected in the financial statements to a limited extent (DAS 640.512). Therefore, the Dutch Accounting Standards provide specific standards for the management board report of foundations and associations, in addition to DAS 400 'Management board report'.

The management board report must not contradict the financial statements (Article 2:391(4) NCC). The management board report covers the foundation or association and the group entities whose financial data are included in its financial statements. The management board report must give a true and fair view of the situation on the reporting date, the development during the financial year and the profit or loss (Article 2:391(1) NCC).

The management board report is prepared at the same time as the financial statements and submitted to the members' meeting, the supervisory body and/or the body competent under the articles of association. See also paragraph 41.1.10.3.

41.5.2 Content of management board report

Depth of information to be provided
The comprehensiveness of the reporting depends partly on the specific nature and size and complexity of the foundation or association and on the group of users, their information needs and the position of these users in relation to the foundation or association (DAS 640.102). This also applies to the management board report.

Information to be provided
This paragraph provides the specific standards for the management board report of foundations and associations. These are in addition to the standards of DAS 400 'Management board report' described in paragraph 1.1.6.3.2.

The management board report should include (DAS 640.513):

- a report of activities;
- a description of what the organisation's objective is;
- which policies pursue that objective and how the principal activities fit into them;
- a representation of the composition of the management board.

Significant changes to the objective (as contained in the articles of association) should be disclosed in the management board report, disclosing reasons (DAS 640.518). The policy of the foundation or association regarding the size and function of its freely disposable equity (see paragraph 41.2.3.2) should be stated. This includes consideration of the recognition of any large profit or loss, as well as the going concern of the foundation or association (DAS 640.517). The foundation or association should disclose the extent to which income is one-off or annual. This provides insight into going concern of income risks (DAS 640.516a).

As the social significance of the activities is only apparent to a limited extent from the financial data in the financial statements, the income and expenses of the activities is presented verbally in the management board report, supported by other types of quantified information where possible (DAS 640.514). If the foundation or association carries out very different types of activities and/or performs activities at very different locations, the relevant items of the balance sheet and statement of income and expenses should be segmented in the financial statements for each main group of activities and locations respectively. See paragraph 41.2.2. The presentation of the management board report follows the presentation according to this segmentation (DAS 640.515).

The management board report should disclose the important firm management intentions and the important decisions taken in the new year. This should include the financial translation of those intentions and decisions. The budget for the year following the reporting period should also be included in summary form, unless this is not useful given the function assigned to the budget by the foundation or association (DAS 640.516). See also paragraph 41.2.4.2.

If a foundation or association has investments, the management board report should include an account of the investment policy pursued and provide an insight into the risks (DAS 640.519).

41.6 Exemptions for medium-sized and small foundations and associations

General
In general, for all foundations and associations, the comprehensiveness of reporting depends, among other things, on the size and complexity of the organisation and on the information needs of the group of users and their position in relation to the organisation (DAS 640.102). See also paragraph 41.1.3.

There are no specific exemptions included in DAS 640 for medium-sized foundations and associations.

For small foundations and associations, standards are included in the Dutch Accounting Standards for micro-sized and small entities, with specific standards in DASsmall C1 'Small not-for-profit organisations'. These standards include certain exemptions for small foundations and associations as compared to medium-sized and large foundations and associations. These exemptions are included below.

Segmented information
Small foundations and associations performing very different types of activities are recommended to provide segmented information (DASsmall C1.402).

Statement of income and expenses with notes
For small foundations and associations, there is no requirement to measure income received in the form of goods or services at fair value. If this income is not included in the statement of income and expenses, it is mentioned in the notes. If relevant for insight, an indication of the fair value of this income is given (DASsmall C1.311).

Small foundations and associations are not subject to the specific obligation to separately present or disclose sponsorship contributions and contributions from members and/or donors (when applying the model by nature of expense). Finally, small foundations and associations do not have to explain how costs are allocated.

Small foundations and associations are not required to disclose information on remuneration (emoluments) for management board members and supervisory board members. However, this is recommended (DASsmall C1.315).

Related party transactions
Small foundations and associations are not required to disclose related party transactions and do not have to disclose audit fees.

Off-balance-sheet arrangements
Small foundations and associations are not required to disclose off-balance-sheet arrangements.

Consolidation
For small foundations and associations, consolidation can be omitted if the conditions of the consolidation exemption for small groups are met (DASsmall C1.401 and Article 2:407(2) NCC). See paragraph 33.3.1.

Mergers and acquisitions
Small foundations and associations are only required to include a description of the method the merger or the acquisition has been recognised in the financial statements (DASsmall B3.203).

Management board report
Small foundations and associations must also prepare a management board report (DASsmall C1.301). The Dutch Accounting Standards for small foundations and associations include the following simplifications:

- the income and expenses of the activities need only be shown if and to the extent that the social significance of the activities is only to a limited extent apparent from the financial data in the financial statements (DASsmall C1.406);
- there is no explicit provision to align the presentation of the management board report with the presentation of activities in the financial statements (if the organisation performs very different types of activities).

41.7 Significant differences from IFRS

Provisions for foundations and associations
The Dutch Accounting Standards have specific provisions for the annual reporting of foundations and associations. IFRS has no specific provisions for the annual reporting of foundations and associations.

Annex 1 Legislation text of Title 9, Book 2 NCC, excluding the provisions for banks and insurers

The legislation text of Title 9 set out below is effective from 1 January 2024.

TITLE 9. The financial statements and the management board report

Part 1. General provision

Article 360

1. This Title is applicable to the cooperative, the mutual guarantee company, the public limited liability entity (NV) and the private limited liability entity (BV). Irrespective of their legal form, this Title is applicable to banks as defined in Article 415, payment institutions as defined in Article 1:1 of the Wft (Financial Supervision Act), and electronic money institutions as defined in Article 1:1 of the Wft.
2. This Title is also applicable to a CV (commanditaire vennootschap - Dutch version of a Limited Partnership) or VOF (vennootschap onder firma - Dutch version of a general partnership) of which all partners with full several liability towards the creditors for the debts are capital companies governed by foreign law.
3. This Title is also applicable to the foundation and the association that maintain one or more businesses which, pursuant to the law, are subject to registration in the trade register, if the net turnover of such businesses for two consecutive financial years and, without interruption thereafter for two consecutive financial years, amounts to one half or more of the amount set out in Article 396 paragraph 1 under b, as amended pursuant to Article 398 paragraph 4. If the foundation or association is required by or pursuant to the law to prepare financial statements equivalent to financial statements as set out in this Title and if these are published, the first sentence is not applicable.

Part 2. General provisions concerning the financial statements

Article 361

1. Financial statements are defined as: the separate financial statements that consist of the balance sheet and the profit and loss account and the accompanying notes, and the consolidated financial statements if the entity prepares consolidated financial statements.
2. Cooperatives and the foundations and associations set out in Article 360 paragraph 3 replace the profit and loss account with a statement of operating income if this serves the insight as referred to in Article 362 paragraph 1; the provisions governing the profit and loss account are similarly applicable to this statement of operating income as far as possible. Provisions relating to profit and loss are similarly applicable to the balance of operating income as much as possible.
3. The provisions of this title apply to financial statements and their components, both in the form as prepared by the management and in the form as adopted by the competent body of the entity.
4. Concerning application of the Articles 367, 370 paragraph 1, 375, 376, 377 paragraph 5 and 381, corresponding disclosures as those pertaining to group entities shall be provided pertaining to other companies:
    a. that are able to exercise rights in the entity pursuant to paragraphs 1, 3 and 4 of Article 24a, irrespective of whether they have legal personality; or
    b. that are a subsidiary of the entity, of a group entity or of a company as referred to in part a.

Article 362

1. The financial statements shall provide, in accordance with generally accepted accounting principles, an insight to such extent that a responsible assessment can be made regarding the equity and profit or loss, and also, insofar the nature of the financial statements allow, regarding the solvency and liquidity of the entity. If so justified by the international branching of its group, the entity may prepare the financial statements in accordance with the generally accepted accounting principles in one of the other European Community member states in order to provide the required insight as set out in the first sentence.
2. The balance sheet and the notes shall fairly, clearly and systematically reflect the amount of the equity and its composition of assets and liabilities as at the end of the financial year. The balance sheet may reflect the equity as prepared taking into account the appropriation of the profit or recognition of the loss, or, if this is not determined, taking into account the relevant proposal. The heading of the balance sheet shall indicate whether the appropriation of the profit or loss has been recognised.
3. The profit and loss account and the notes shall fairly, clearly and systematically reflect the amount of the profit

or loss of the financial year and how it is derived from the income and expense items.

4. If required for providing the insight required pursuant to paragraph 1, the entity shall provide information in the financial statements supplementary to the requirements of the special provisions of and pursuant to Title 9. If this is necessary for providing the relevant insight, the entity shall derogate from the provisions; the reason of such derogations shall be set out in the notes, insofar necessary stating the impact on equity and profit or loss.
5. The income and expenses of the financial year shall be recognised in the financial statements, irrespective of whether these have resulted in receipts or expenditures in that financial year.
6. The financial statements shall be adopted taking into account the facts that have appeared concerning the financial situation as at balance sheet date between the preparation of the financial statements and the general meeting in which these are dealt with, insofar this is indispensable to the insight referred to in paragraph 1. If it subsequently appears that the financial statements are seriously defective in providing this insight, the management shall, without delay, report to the members or shareholders accordingly and file a notice thereon with the trade register; this notice shall be accompanied by an auditor's report if the financial statements were audited in accordance with Article 393. An entity with securities admitted to trading on a regulated market as defined in the Wft (Financial Supervision Act) is deemed to have complied with the obligation of filing the notice referred to in the second sentence with the trade register if it has sent the relevant notice to the AFM (Financial Markets Authority foundation) pursuant to Article 5:25 m, fifth paragraph of that Act.
7. If justified by the operations of the entity or the international branching of its group, the financial statements or only the consolidated financial statements may be prepared in a foreign currency. The items shall be described in the Dutch language, unless the general meeting has decided to use a different language.
8. An entity may prepare the financial statements in accordance with the standards adopted by the International Accounting Standards Board and approved by the European Commission, provided that the entity applies all adopted and approved standards that are applicable to it. An entity that prepares the consolidated financial statements in accordance with this Title is not permitted to prepare the separate financial statements in accordance with the adopted and approved standards. An entity preparing the consolidated financial statements in accordance with the standards set out in the first sentence of this paragraph may apply the measurement policies in the separate financial statements as it also applied in the consolidated financial statements.
9. The entity that prepares the financial statements in accordance with the standards set out in paragraph 8, shall apply of this Title only the Parts 7 up to and including 10 and the Articles 362, paragraph 6, sentence before the final sentence, paragraph 7, final sentence and paragraph 10, 365 paragraph 2, 373, 379 paragraphs 1 and 2, 380b, sub d, 382, 382a, 383, 383b up to and including 383e, 389 subsequently 8 and 10, and 390. Banks shall also apply Article 421 paragraph 5. Insurers shall also apply Article 441 paragraph 10.
10. The entity shall disclose in the notes which standards have been applied in the financial statements.

Article 363

1. Combination, specification and ordering the information in the financial statements and the notes to this information shall be focused on providing the legally required insight that financial statements are intended to present pursuant to Article 362 paragraph 1. This is subject to observing the provisions pursuant to paragraph 6 and the other parts of this title. The notes shall have the same order as the items.
2. Netting assets and liabilities or income and expenses is not permitted if these must be recognised in separate items pursuant to this title.
3. An item does not need to be recognised separately if, in view of the overall financial statements, this item is of negligible significance to the insight required by law. Any disclosure pursuant to this title may be left out insofar it would by itself and in combination with similar disclosures would have negligible significance concerning the required insight. Disclosures pursuant to the Articles 378, 382 and 383 shall not be left out.
4. The format of the balance sheet and the profit and loss account may differ from that presented in the previous year only for well-founded reasons; in the notes, the differences and the reasons on which these were based shall be disclosed.
5. Insofar as possible, the amounts of items in the preceding financial year shall be stated for each item in the financial statements; insofar as necessary for comparability, these shall be restated and the deviation resulting from such restatements shall be disclosed.
6. For the format of the financial statements we may adopt models and further rules in a general administrative order, which shall apply for the entities described therein. For the application thereof, the format, title and description of the relevant items shall be adapted to the nature of the entity's business, insofar this is permissible pursuant to such administrative orders.

Part 3. Provisions concerning the balance sheet and the relevant notes

§ 1. Main format of the balance sheet

Article 364

1. In the balance sheet the assets shall be classified into fixed and current assets, depending on whether they are intended for long-term support of the entity's business or not.
2. The fixed assets shall present separately the intangible, tangible and financial fixed assets.
3. The current assets shall present separately the inventories, receivables, securities, cash and cash equivalents and, insofar as these are not included in receivables, prepayments and accrued income.
4. Liabilities and equity shall present separately the equity, the provisions, the debts and, insofar as not included in debts, accruals and deferred income.

§ 2. Assets

Article 365

1. The following items shall be presented separately in intangible fixed assets:
   a. costs related to incorporation and issuing shares;
   b. development costs;
   c. costs of acquisition regarding concessions, licenses and rights to intellectual property;
   d. costs of goodwill acquired from third parties;
   e. prepayments on intangible fixed assets.
2. Insofar the entity capitalises the costs stated in a and b of paragraph 1, these shall be disclosed and a reserve to that amount shall be recognised.

Article 366

1. The following items shall be presented separately in tangible fixed assets:
   a. buildings and land;
   b. machines and equipment;
   c. other operating fixed assets, such as technical and administrative equipment;
   d. tangible fixed assets under construction and prepayments on tangible fixed assets;
   e. tangible fixed assets not used in the production process.
2. If the entity has only a limited commercial or personal long-term right of enjoyment to or relevant to such tangible fixed assets, this shall be disclosed.

Article 367

The following items shall be presented separately in financial fixed assets:

a. shares, certificates of shares and other forms of participating interests in group entities;
b. other participating interests;
c. receivables from group entities;
d. receivables from other entities and companies that have a participating interest in the entity or in which the entity has a participating interest;
e. other securities;
f. other receivables, with separate disclosure of the receivables from loans and advance payments to members or registered shareholders.

Article 368

1. The movement of each of the items that are part of the fixed assets during the financial year shall be presented in a reconciliated statement. This shall disclose the following:
   a. the book value at the beginning of the financial year;
   b. the sum of the values at which the assets acquired during the financial year are recorded, and the sum of the book values of the assets no longer at the entity's disposal at the end of the financial year;
   c. the revaluations during the financial year in accordance with Article 390 paragraph 1;
   d. depreciations, amortisations, impairments and the relevant reversals during the financial year;
   e. the book value at the end of the financial year.
2. Furthermore, for each of the items that are part of fixed assets, the following shall be presented:
   a. the sum of the revaluations that relate to the assets present on the balance sheet date;

b. the sum of depreciations, amortisations and impairments as at balance sheet date.

Article 369

Inventories that are part of the current assets shall present separately the following:

a. raw materials and supplies;
b. work in progress;
c. finished products and trade goods;
d. prepayments on inventories.

Article 370

1. Receivables that are part of the current assets shall present separately the following:
   a. receivables from trade debtors;
   b. receivables from group entities;
   c. receivables from other entities and companies that have a participating interest in the entity or in which the entity has a participating interest;
   d. issued capital called but not paid up;
   e. other receivables, with the exception of receivables subject to Articles 371 and 372, and with separate disclosure of the receivables from loans and advance payments to members or holders of registered shares.
2. For each of the groups of assets set out in paragraph 1, the amount with a remaining term of more than one year shall be stated.

Article 371

1. If the current assets include shares and other forms of interests in non-consolidated companies as set out in Article 361 paragraph 4, these are presented separately in securities. The aggregate value of the other securities that are part of the current assets shall be disclosed if admitted to trading on a regulated market or a multilateral trading facility, as set out in Article 1:1 of the Wft (Financial Supervision Act), or a system equivalent to a regulated market or multilateral trading facility in a non-member state.
2. Concerning securities, it shall be disclosed to what extent these are not at the entity's free disposal.

Article 372

1. Cash and cash equivalents include cash, the balances of bank and giro accounts, bills of exchange and cheques.
2. Concerning the balances of accounts, it shall be disclosed to what extent these are not at the entity's free disposal.

§ 3. Liabilities and equity

Article 373

1. The equity shall present separately:
   a. the issued capital;
   b. share premium;
   c. revaluation reserves;
   d. other legal reserves, discerned based on their nature;
   e. statutory reserves;
   f. other reserves;
   g. unappropriated profit or loss, with separate disclosure of the profit or loss after tax for the financial year, insofar the appropriation is not recognised in the balance sheet.
2. If the issued capital is not fully paid up, the paid-up capital shall be disclosed instead, or, if deposits are called, the paid- up and called capital. In such cases, the issued capital shall be disclosed.
3. The capital shall not be reduced by the amount of own shares or certificates of own shares held by the entity or a subsidiary.
4. Legal reserves are the reserves to be recognised and held pursuant to the Articles 67a paragraphs 2 and 3, 94a paragraph 6 under f, 98c paragraph 4, 365 paragraph 2, 389 paragraphs 6 and 8, 390, 401 paragraph 2 and 423 paragraph 4.
5. In financial statements prepared in a foreign currency, the item set out in paragraph 1 sub a shall be recognised in the relevant currency, at the exchange rate as at balance sheet date. If the Articles of Association set out the issued capital in a currency other than the currency in which the financial statements have been prepared, the item set out in paragraph 1 sub a shall also be disclosed with this exchange rate and the amount in the other currency.

Article 374

1. On the balance sheet, provisions shall be recognised for obligations that have a clear description of their nature and that are regarded as probable or final as at balance sheet date, but for which is not yet known the exact amount or when these will arise. Also, provisions may be recognised for expenditure to be made in a subsequent financial year, insofar making such expenditure partly originates before the end of the financial year, and the provision serves to evenly distribute expenses over a number of financial years.
2. Diminution in value of an asset shall not be reflected by recognising a provision.
3. The provisions shall be classified based on the nature of the obligations, losses and costs for which these are recognised; these shall be accurately specified in accordance with their nature. As far as possible, the notes shall indicate to what extent the provisions shall be considered as non-current.
4. In any case, the following shall be presented separately:
   a. the provision for tax liabilities that may arise after the financial year, but that must be allocated to the financial year or a previous financial year, including the provision for taxes that may arise from measurement above the acquisition cost or manufacturing cost;
   b. the provision for pension liabilities.

Article 375

1. The following items shall be presented separately under the debts:
   a. bond loans, mortgage bonds and other loans, with separate report of the convertible loans;
   b. debts to banks;
   c. advance payments received on orders insofar as not already deducted from asset items;
   d. debts to suppliers and trade credits;
   e. bills of exchange and cheques to be paid;
   f. debts to group entities;
   g. debts to entities and companies that have a participating interest in the entity or in which the entity has a participating interest, insofar as not mentioned already under f;
   h. debts in respect of taxes and social insurance contributions;
   i. debts in respect of pensions;
   j. other debts.
2. For each group of debts set out in paragraph 1, the entity shall indicate which amount has a remaining term of more than one year, indicating the relevant interest rate. For the total of the debts set out in paragraph 1, it shall be indicated which amount has a remaining term of more than five years.
3. For the total of the groups set out in paragraph 1, it shall be disclosed for which debts corporate collateral has been provided, and in which form. Furthermore, the entity shall disclose for which debts the entity has committed, whether or not conditionally, to encumber or not encumber goods, insofar as necessary for the required insight as set out in Article 362 paragraph 1.
4. It shall be indicated to which amount debts are subordinated to the other debts; the nature of such subordination shall be disclosed.
5. If the amount repayable on the debt exceeds the amount received, the difference, provided it is stated separately, may be capitalised latest until repayment.
6. The amount shall be disclosed that the entity must repay during the financial year following that to which the financial statements related, on loans presented in debts with a remaining term of more than one year.
7. The conversion conditions shall be disclosed for convertible loans.

Article 376

If the entity has assumed liability for the debts of others, or if it is exposed to risk for discounted bills of exchange or cheques, the liabilities arising therefrom, insofar no provisions were recognised for them in the balance sheet, shall be disclosed and classified based on the form of collateral offered. The commitments entered into for group entities shall be disclosed separately.

Part 4. Provisions concerning the profit and loss account and the relevant notes

Article 377

1. The following shall be presented separately on the profit and loss account:
   a. the income and expenses from ordinary activities, the taxes thereon and the profit or loss from the ordinary activities after taxes;
   b. the other taxes;

   c. the profit or loss after tax.
2. The income and expenses from the ordinary activities shall be either specified based on paragraph 3 or paragraph 4.
3. The following shall be presented separately:
   a. the net turnover;
   b. the increase or decrease of the inventories of finished products and work in progress compared with the preceding balance sheet date;
   c. the capitalised production for the own business;
   d. the other operating income;
   e. the wages;
   f. the social security costs with separate disclosure of the pension costs;
   g. the costs of raw materials and supplies and the other external costs;
   h. the depreciations, amortisations and diminutions in value charged to the intangible and the tangible fixed assets, split into those groups of assets;
   i. value diminutions of current assets, insofar as they exceed the usual value diminutions for the entity;
   j. the other operating costs;
   k. the profit or loss from participating interests;
   l. income from other securities and receivables that are part of fixed assets;
   m. the other interest income and similar income;
   n. the changes in the value of the financial fixed assets and of the securities that are part of the current assets;
   o. the interest expenses and similar costs.
4. The following shall be presented separately:
   a. the net turnover;
   b. the cost of sales, except for the included interest costs, but including the depreciations, amortisations and value diminutions;
   c. the gross profit or loss on turnover, being the balance of the items a and b;
   d. the selling costs including the depreciations, amortisations and value diminutions;
   e. the general administrative costs including the depreciations, amortisations and value diminutions;
   f. the other operating income;
   g. the profit or loss from participating interests;
   h. the income from other securities and receivables that are part of the fixed assets;
   i. the other interest income and similar income;
   j. the changes in the value of the financial fixed assets and of the securities that are part of the current assets;
   k. the interest expenses and similar costs.
5. For the items k–o of paragraph 3 and the items g–k of paragraph 4, the income and expenses from the relations with group companies shall be separately disclosed.
6. Net turnover is defined as the revenue from the goods supplied and services rendered by the entity’s business, after deduction of discounts etc. and taxes levied on turnover.
7. Income and expenses that should be allocated to a different financial year, shall be disclosed based on their nature and amount.
8. The amount and nature of income and expense items of exceptional size or incidence shall be disclosed.

Part 5. Special provisions concerning the notes

Article 378

1. The movements in the equity during the financial year shall be presented in a statement. This shall disclose the following:
   a. the book value of each item at the beginning of the financial year;
   b. the additions to and reductions in each item during the financial year, specified by their nature;
   c. the amount of each item at the end of the financial year.
2. In the statement, the item paid-up and called capital shall be specified per class of shares. The closing position and the information regarding the movement in the own shares and certificates thereof in the entity’s capital held by the entity, or on its behalf by one of its subsidiaries, shall be separately disclosed. The notes shall disclose from which item in equity the acquisition cost or book value of the own shares was deducted.
3. The notes shall disclose in which form payments on shares have been made during the financial year, either called or on a voluntary basis, with a summary of the substance of the legal acts completed in the financial year

to which Article 94, Article 94c or Article 204 applies. A public limited liability entity shall disclose each acquisition and disposal of own shares and certificates thereof for its account; the reasons for acquisition, the number, nominal amount and agreed price of the shares concerned for each transaction of the relevant shares or certificates of shares and the portion of capital represented by such shares shall be disclosed.

4. A public limited liability entity shall disclose information relating to the number, class and nominal amount of the own shares or the certificates thereof:
   a. that are pledged to the entity or to other entities on its behalf as at balance sheet date;
   b. that are held by the entity or one of its subsidiaries as at balance sheet date pursuant to acquisition under Article 98 paragraph 5.

Article 379

1. The entity shall disclose the name, place of residence and the portion contributed in the issued capital of each company:
   a. in which the entity, solely or jointly with one or more subsidiaries, contributes or arranges to contribute at least one fifth of the issued capital for its own account.
   b. in which it, as a partner, is fully liable for the debts towards the creditors.
2. For each company listed in sub a of paragraph 1 above, the entity shall also disclose the amount of the equity and profit or loss according to the most recently adopted financial statements, unless:
   a. the entity consolidates the financial information of the company;
   b. the entity accounts for the company in its balance sheet or consolidated balance sheet in accordance with Article 389 paragraphs 1 up to and including 7;
   c. the entity does not consolidate the financial information of the company based on negligible significance or pursuant to Article 408; or
   d. less than half of the capital of the company is contributed for the account of the entity and the company lawfully does not publish its balance sheet.
3. Unless such a company lawfully does not tend to report its interest in the entity, the entity shall disclose the following:
   a. the name and place of residence of the entity that is the head of the group, and
   b. the name and place of residence of any company that consolidates financial information in its published consolidated financial statements, and the place where copies thereof may be obtained at no more than cost.
4. At the entity's request, our Minister of Economic Affairs may grant dispensation from the obligations set out in paragraphs 1, 2 and 3, if there is a justified reason to suspect serious prejudice due to such disclosures. Such dispensation may be granted for a maximum of five years at a time. The disclosure shall state that dispensation has been granted or requested for. Publication is not required pending such a request.
5. The disclosures required pursuant to this Article and Article 414 may be disclosed in conjunction. The entity may separately file the portion of the notes that set out the above disclosures with the trade register for the public record, provided that both parts of the notes are cross-referenced.

Article 380

1. If the organisation of the entity's activities is based on operations in different industries, insight shall be provided with the aid of figures into the extent to which each type of activities has contributed to the net turnover.
2. The net turnover shall be segmented similarly into the separate geographical areas in which the entity supplies goods and renders services.
3. Article 379 paragraph 4 is similarly applicable.

Article 380a

The entity shall disclose any subsequent events which are not reflected in the balance sheet or the profit and loss account and that have significant financial implications for the entity and its consolidated companies together, disclosing the magnitude of such implications.

Article 380b

The following shall be disclosed:

a. the name of the entity;
b. the legal form of the entity;
c. the seat of the entity; and

d. the number assigned by the Chamber of Commerce as referred to in Article 9, sub a, of the 2007 Trade Register Act, used to register the entity in the trade register.

Article 380c
The entity shall disclose the appropriation of the profit or recognition of the loss, or, as long as this is not determined, the relevant proposal.

Article 380d
The entity shall disclose the number of profit participation certificates and similar rights, disclosing the relevant authorisations.

Article 381

1. The entity shall disclose the significant off-balance sheet financial liabilities that the entity is committed to for a number of future years, such as those ensuing from long-term contracts. Additionally, the entity shall disclose which contingent assets, contingent obligations and unrecognised obligations the entity has committed to. The liabilities towards group companies shall be disclosed separately. Article 375 paragraph 3 is similarly applicable.
2. The entity shall also disclose the nature, business purpose and financial consequences of off-balance sheet arrangements if the risks or benefits ensuing from these arrangements are significant and insofar disclosure of such risks or benefits is required for the assessment of the entity's financial position.
3. The entity shall disclose any significant transactions that the entity completed not on an arm's length basis with related parties as referred to in the standards as adopted by the International Accounting Standards Board and endorsed by the European Commission, the amount of such transactions, the nature of the relationship with the related party, and any other information regarding such transactions required to provide insight into the financial position of the entity. Information regarding individual transactions may be combined in line with its nature, unless separate information is required to provide an insight into the consequences of transactions with related parties for the financial position of the entity. Disclosure of transactions between two or more group members may be omitted, provided that the subsidiaries that are party to this transaction are fully owned by one or more group members.

Article 381a
If financial instruments are measured at current value, the entity shall disclose:

a. if the current value is measured using valuation models and methods: the underlying assumptions;
b. per category of financial instruments, the current value, the changes in value which are recognised in the profit and loss account, the changes in value which are recognised on grounds of Article 390 paragraph 1 in the revaluation reserve, and the changes in value which have been deducted from the free reserves; and
c. per category of derivative financial instruments, information about the amount and nature of the instruments, as well as the conditions that could have an impact on the amount, the time and the certainty of future cash flows.

Article 381b
If financial instruments are not measured at current value, the entity shall disclose:

a. for every category of derivative financial instruments:
   1°. the current value of the instruments, if this can be determined based on one of the methods required pursuant to Article 384 paragraph 4;
   2°. information on the amount and nature of the instruments; and
b. for financial fixed assets measured above the current value and without implementing the second sentence of Article 387 paragraph 4:
   1°. the book value and current value of the individual assets or of appropriate groups of individual assets;
   2°. the reason why the book value was not reduced, as well as the nature of the indications that form the basis of the assumption that the book value can be realised.

Article 382
The average number of employees employed by the entity during the financial year shall be disclosed, specified in a way that is aligned with the organisation of the business. In this context, the company shall disclose the number of employees stationed outside the Netherlands. If Article 377 paragraph 3 has not been applied in the profit and loss account, the information required pursuant to e and f shall be disclosed.

Article 382a

1. The entity shall disclose the total fees charged to the entity during the financial year for the examination of the financial statements, the total fees for other audit engagements, the total fees for consultancy relating to taxes and the total fees for other non-audit services performed by the external auditor and the audit firm as referred to in Article 1, first paragraph, under a and e, of the Audit Firms Supervision Act.
2. If the entity has subsidiaries or consolidates the financial information of other companies, the fees charged to them in the financial year shall be included in the above disclosure.
3. Disclosure of the above fees is not required if the entity's financial information is consolidated in consolidated financial statements to which pursuant to applicable law the Regulation of the European Parliament and of the Council concerning application of the international standards for financial statements, or Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the financial statements, consolidated financial statements and associated reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC of the Council (*OJEU* 2013, L 182) is applicable, provided that the fees referred to in paragraph 1 are disclosed in the notes of the relevant consolidated financial statements.

Article 383

1. The entity shall disclose the amounts of the remunerations, including pension costs, and of the other benefits made in the aggregate to the directors and former directors and, separately, in the aggregate to the supervisory board members and former board members. The previous sentence pertains to the amounts that were charged to the entity in the financial year. If the entity has subsidiaries or consolidates the financial information of other companies, the amounts that were charged to them in the financial year shall be included in the above disclosure. A statement that can be traced to a single natural person may be omitted.
2. With the exception of the latter sentence, paragraph 1 is also applicable to the amount of the loans, advance payments and guarantees granted to the entity's management board members and supervisory board members by the entity, its subsidiaries and the companies it has consolidated. The amounts outstanding, the impaired amounts and the amounts which were waived shall be disclosed, as well as the interest rate, the most important other provisions and the repayments during the financial year.

Article 383a

The foundations and associations referred to in Article 360 paragraph 3 shall disclose both the statutory provisions relating to the appropriation of the profit or loss and how the profit or loss after tax is appropriated.

Article 383b

In derogation of Article 383, the Articles 383c up to and including 383e apply for the public limited liability entity, with the exception of the public limited liability entity for which the Articles of Association exclusively provide for registered shares, contain share transfer restrictions and do not permit the issue of non-registered certificates with the company's co- operation and with the exception of the public limited liability entity whose shares or certificates issued with the cooperation of the company are admitted to trading on a regulated market as referred to in Article 1:1 of the Wft (Financial Supervision Act).

Article 383c

1. The company shall disclose the amount of remuneration for each management board member. This amount shall be specified according to:
   a. periodically paid remunerations;
   b. remunerations payable in the future;
   c. payments on the termination of the employment,
   d. profit sharing and bonus payments, insofar these amounts were charged to the company in the financial year. If the company paid out a remuneration in the form of a bonus that is fully or partially based on achieving objectives set by or on behalf of the company, it shall disclose this. The company shall disclose whether the relevant objectives were achieved during the financial year.
2. The company shall disclose the amount of remuneration for each former management board member, specified for remunerations payable in the future and payments upon termination of employment, insofar such amounts were charged to the company in the financial year.
3. The company shall disclose the amount of the remuneration for each supervisory board member insofar such amounts were charged to the company in the financial year. If the company granted a remuneration in the form of profit sharing or a bonus, this shall be reported separately, stating the reasons underlying the resolution to

grant such a form of remuneration to a supervisory board member. The last two sentences of paragraph 1 are similarly applicable.
4. The company shall disclose the amount of the remuneration for each former supervisory board member insofar such amounts were charged to the company in the financial year.
5. If the company has subsidiaries or consolidates the financial information of other companies, the amounts that were charged to them in the financial year shall be included in the disclosures, allocated to the relevant remuneration category as set out in paragraphs 1 up to and including 4.
6. The company discloses the amount of adjustment or recovery of the remuneration as referred to in Article 135 paragraph 6 up to and including 8.

Article 383d

1. A company that grants rights to management board members or employees to subscribe for or acquire shares in the capital of the company or a subsidiary, shall disclose the following for each management board member and for the employees jointly:
   a. the exercise price of the rights and the price of the underlying shares in the company's capital if the exercise price is below the price of the shares on the date the rights were granted;
   b. the number of rights not yet exercised at the beginning of the financial year;
   c. the number of the rights granted by the company in the financial year, with the applicable conditions; if such conditions are amended during the financial year, such changes shall be disclosed separately;
   d. the number of rights exercised during the financial year, in any case disclosing the number of the shares related to the exercise and the exercise prices;
   e. the number of rights not yet exercised at the end of the financial year, disclosing:
      – the exercise price of the rights granted;
      – the remaining term of the rights not yet exercised;
      – the main conditions that apply for exercising the rights;
      – a financing arrangement made in connection with the grant of the rights; and
      – any other details that are relevant for the assessment of the value of the rights granted;
   f. if applicable: the criteria that the company applies to granting or exercising the rights.
2. A company that grants rights to supervisory board members to subscribe for or acquire shares in the capital of the company or a subsidiary, shall furthermore disclose such rights for each supervisory board member, and the reasons underlying the resolution to grant such rights to the supervisory board member. Paragraph 1 is similarly applicable.
3. The company shall disclose how many own shares have been repurchased at balance sheet date or will be purchased after balance sheet date, or how many new shares have been issued at balance sheet date or will be issued after balance sheet date in the context of exercising the rights referred to in paragraphs 1 and 2.
   For the application of this Article, the definition of shares also includes certificates of shares that were issued with the co-operation of the company.

Article 383e

The company shall disclose the amount of the loans, advance payments and guarantees granted to each management board member and supervisory board member by the entity, its subsidiaries and the companies it has consolidated. The company shall also disclose the amounts outstanding, the interest rate, the most important other provisions and the repayments during the financial year.

Part 6. Provisions regarding the policies for measurement and for determination of the profit or loss

Article 384

1. In choosing a measurement policy for an asset and for a liability and for the determination of the profit or loss, the provisions set out in Article 362 paragraphs 1-4 shall be leading to the entity. The acquisition cost or manufacturing cost and the current value are eligible for the policy.
2. The application of the policies requires prudence. Profits are recognised only insofar as realised as at balance sheet date. Liabilities originating before the end of the financial year shall be taken into account if these were known before preparation of the financial statements. Any foreseeable liabilities and potential losses originating before the end of the financial year may be taken into account if these were known before preparation of the financial statements.
3. The measurement of assets and liabilities shall be based on the assumption that the entity's entire operations for which the assets and liabilities are instrumental, will be continued, unless this assumption is incorrect or if

there is serious doubt about this assumption; in that case, this shall be disclosed in the notes, stating the impact on equity and profit or loss.

4. Rules regarding the content, the limits and the method of how to apply measurement at current values may be imposed in a general administrative order.
5. The policies of measurement of the assets and the liabilities and the determination of the profit or loss shall be disclosed for each of the relevant items. The policies for translation of amounts expressed in foreign currencies shall be disclosed; also, the company shall disclose how translation differences have been recognised.
6. The measurement of assets and liabilities and the determination of the profit or loss may only be based on policies other than those applied in the previous financial year for justified reasons. The reason of the change shall be disclosed in the notes. The company shall also disclose the impact on its equity and profit or loss based on restated figures for the financial year or for the preceding financial year.
7. Changes in value of:
   a. financial instruments
   b. other investments; and
   c. agricultural inventories with frequent market quotations that are measured at current value pursuant to paragraph 1, may be recognised directly in the profit or loss in derogation of paragraph 2, unless determined otherwise in this Part. Changes in the value of derivative financial instruments, insofar not those referred to in paragraph 8, are taken to or charged directly to the profit or loss, if necessary in derogation of paragraph 2.
8. Changes in the value of financial instruments that serve and are effective in hedging risks relating to assets, assets on order and other liabilities not yet recognised in the balance sheet, or relating to proposed transactions, shall be taken or charged directly to the revaluation reserve insofar as necessary to ensure that such changes in value are recognised in the profit or loss in the same period as the changes in value these are designed to hedge.

Article 385

1. The assets and liabilities shall, insofar as they differ in terms of their significance for the insight referred to in Article 362 paragraph 1, be measured separately.
2. The measurement of similar components of inventories and securities may be based on applying weighted average prices, the 'first in first out' (Fifo) rules, the 'last in first out' (Lifo) rules, or similar rules.
3. Tangible fixed assets and inventories of raw materials and supplies that are frequently replaced and have a negligible aggregate value, may be recorded at a fixed quantity and value, provided that the quantity, composition and value are subject to minor fluctuations only.
4. The assets referred to in Article 365 paragraph 1 under d and e are measured at no more than the expenditure incurred thereon, less depreciations.
5. Own shares or certificates thereof held by or on behalf of the entity shall not be capitalised. The value attributed to the interest in a subsidiary shall, proportionately to the interest or otherwise, be reduced by the acquisition cost of the own shares of the entity and certificates thereof held by or on behalf of the subsidiary for its own account; if it has acquired such shares or certificates thereof before the date on which it became a subsidiary, their book value on that date or a proportionate part thereof shall be deducted.

Article 386

1. The depreciations shall be applied independent of the profit or loss in the financial year.
2. The methods applied in the calculation of the depreciations shall be disclosed in the notes.
3. The capitalised costs related to incorporation and issuing shares shall be amortised over no more than five years. The development costs insofar capitalised and the capitalised costs of goodwill shall be amortised in line with the expected economic life. If in exceptional cases it is not possible to reliably estimate the economic life of development and goodwill, such costs shall be amortised over a period of no more than ten years. In such cases, the notes shall disclose the justified reasons for the amortisation term of the goodwill costs.
4. Fixed assets with a limited economic life are annually depreciated using a system based on the expected future economic life.
5. The part of a debt that is capitalised as an asset in accordance with Article 375 paragraph 5 is depreciated annually for a reasonable part until the repayment.

Article 387

1. Depreciation on assets shall be applied independent of the profit or loss in the financial year.
2. Current assets shall be measured at current value, if this is below the acquisition cost or manufacturing cost as

at balance sheet date. The assets are measured at a different lower value if this serves the insight referred to in Article 362 paragraph 1.
3. The measurement of fixed assets shall factor in a decrease in their value if this is expected to be of a long-term nature. The measurement of financial fixed assets may in any case factor in the value decrease as at balance sheet date.
4. The deduction in accordance with the previous paragraphs shall be charged to the profit and loss account insofar it is not deducted from the revaluation reserve pursuant to Article 390 paragraph 3. Such deductions shall be reversed as soon as the impairment has ceased to exist. The deductions pursuant to paragraph 3, and the relevant reversals, shall be stated separately in the profit and loss account or in the notes.
5. The second sentence of paragraph 4 does not apply to goodwill impairments.

Article 388

1. The acquisition cost at which an asset is measured includes the purchase price and the additional costs.
2. The manufacturing cost at which an asset is measured includes the acquisition cost of the raw materials and supplies and the other production costs that can be directly attributed to manufacturing. The manufacturing cost may also include a reasonable portion of the indirect cost and the interest on debts on the period that can be allocated to the manufacturing of the asset. In that case, the notes shall disclose that this interest is capitalised.

Article 389

1. The participating interests in companies in which the entity has significant influence on the business and financial policy are accounted for in accordance with the paragraphs 2 and 3. If the entity or one or more of its subsidiaries solely or jointly can exercise one fifth or more of the votes of the members, partners or shareholders at their discretion, the entity shall be presumed to exercise significant influence.
2. The entity shall determine the participating interest's net equity value by measuring the assets, provisions and debts and determining the profit or loss of the company in which it participates according to the same policies as its own assets, provisions, debts and profit or loss. This measurement method shall be disclosed.
3. If the entity has insufficient information to determine the net equity value, it may apply a value that is determined in a different way in accordance with this title, changing this value by the amount of its share in the profit or loss and in the distributions of the company in which it participates. This measurement method shall be disclosed.
4. In the financial statements of an entity that is not a bank as set out in Article 415, a participating interest in a bank may be accounted for in accordance with Part 14 of this title. In the financial statements of a bank as set out in Article 415, a participating interest in an entity that is not a bank is accounted for in accordance with the provisions for banks, with the exception of Article 424 and without prejudice to the first sentence of paragraph 5. This exception does not need to be applied for participating interests that serve to complete work that is directly in line with the banking operations. This exception does not need to be applied relating to participating interests in which operations are conducted that are directly in line with the banking operations.
5. In the financial statements of an entity that is not an insurer as set out in Article 427, a participating interest in an insurer may be accounted for in accordance with Part 15 of this title. In the financial statements of an insurer as set out in Article 427, a participating interest in an entity that is not an insurer shall be accounted for in accordance with the provisions for insurers, without prejudice to the first sentence of paragraph 4 of this Article.
6. The entity maintains a reserve amounting to its share in the positive profit or loss from participating interests and in direct equity increases since the initial measurement in accordance with paragraphs 2 or 3. Participating interests for which the cumulative profit or loss since the initial measurement is not positive, are not taken into account. The reserve is reduced by the distributions that the entity is entitled to from then up to the date of adopting the financial statements, and the direct equity decreases in the participating interest; distributions that can be completed without restrictions are also deducted. This reserve may be converted into capital. Share distributions are not in the scope of the distributions referred to in this paragraph.
7. If the value upon initial measurement in accordance with paragraphs 2 or 3 is below the acquisition cost or the previous book value of the participating interest, the difference shall be capitalised as goodwill. For this calculation, the acquisition cost shall also be reduced in accordance with Article 385 paragraph 5.
8. Value increases or value decreases of participating interests due to translation of the invested equity and the profit or loss from the participating interest's currency into the currency in which the entity's financial statements are prepared, are taken to respectively charged to a reserve for translation differences. Currency exchange rate differences on loans concluded to hedge currency risk of foreign subsidiaries are also taken to,

respectively charged to the translation differences reserve. The reserve may have a negative balance. In the event of full or partial disposal of the share in the relevant participating interest, the portion of the reserve relating to the disposed share in this participating interest shall be released from this reserve. If the reserve for translation differences has a negative balance, no distributions can be made from the reserves to the amount of this balance.

9. Derogation from the application of paragraph 1 is permitted for justified reasons, which shall be disclosed in the notes.
10. Differences between the equity and the profit or loss according to the separate financial statements and according to the consolidated financial statements are disclosed in the notes to the separate financial statements.

Article 390

1. Value increases of tangible fixed assets, intangible fixed assets and inventories other than agricultural inventories, shall be recognised directly in a revaluation reserve. Value increases of other assets that are measured at current value are recognised in a revaluation reserve, unless these are taken to the profit or loss pursuant to Article 384. Furthermore, the entity shall recognise a revaluation reserve charged to the free reserves or from the profit or loss of the financial year, insofar value increases on assets still recognised at balance sheet date are taken to the profit or loss of the financial year. If frequent market quotations are available for assets referred to in the previous sentence, no revaluation reserve shall be recognised. To the amount of deferred losses on financial instruments charged to the revaluation reserve as referred to in Article 384 paragraph 8, no distributions can be made from the reserves. Deferred tax liabilities relating to assets revaluated to a higher amount may be deducted from the revaluation reserve.
2. The revaluation reserve may be converted into capital.
3. The revaluation reserve shall not exceed the difference between the book value based on the acquisition cost or manufacturing cost, and the book value based on the current value applied in the measurement of the assets that the revaluation reserve relates to. Upon disposal of an asset, the amount that was added to this reserve for the relevant asset is deducted. A value decrease of an asset measured at current value shall be charged to the revaluation reserve insofar value increases of this asset were previously taken to the same revaluation reserve.
4. The deductions from the revaluation reserve that are taken to the profit and loss account, shall be stated in a separate item.
5. If applicable, the notes shall report if, and if yes how, the impact of taxes on equity and profit or loss is taken into account in the context of revaluation.

Part 7. Management board report and separate annual reports and statements

Article 391

1. The management board report shall provide a true and fair view of the position on the balance sheet date, the development during the financial year and the profit or loss of the entity and of the group companies whose financial information is included in its financial statements. In accordance with the size and complexity of the entity and group companies, the management board report shall provide a balanced and comprehensive analysis of the position on the balance sheet date, the development during the financial year and the profit or loss. If necessary for a proper understanding of the development, the profit or loss or the position of the entity and group companies, the analysis shall present both financial and non- financial performance indicators, including environmental and employee issues. The management board report shall also contain a description of the principal risks and uncertainties that the entity is facing. The management board report shall be prepared in the Dutch language, unless the general meeting has decided to use a different language.
2. The management board report shall provide information relating to the expected course of events; in this context, particular attention shall be paid to the investments, the financing and the staffing, and to the circumstances affecting the development of the turnover and the profitability, insofar as important interests do not oppose to this. Information is provided on the activities in the field of research and development. In the management board report, the public limited liability company shall notify of the provisions of Article 82 paragraphs 3 up to and including 9. It shall be disclosed how special events, that need not have to be reflected in the financial statements, have impacted the outlook. The public limited liability company to which Article 383b applies, shall furthermore set out the company’s policy in respect of the remuneration of its directors and supervisory board members and the manner in which this policy was implemented during the financial year.
3. Relating to the use of financial instruments by the entity and insofar as that is significant for the assessment of

its assets, liabilities, financial position and profit or loss, the entity's objectives and policy regarding risk management shall be stated. Thereby, attention shall be paid to the policy regarding the hedging of risks related to all major types of forecast transactions. Furthermore, attention shall be paid to the price, credit, liquidity and cash flow risks incurred by the entity.
4. The management board report shall not conflict with the financial statements. If necessary for providing the insight as referred to in paragraph 1, the management board report shall include references to and additional explanations concerning items in the financial statements.

Article 391a

1. Further rules may be set by Order in council regarding the content of the management board report.
2. By Order in council, in implementation of binding EU legal acts, rules may be laid down regarding the obligations of certain entities and branches to include information in the management board report, to prepare and disclose a separate annual report and to draw up and disclose one or more related statements. The rules may relate in particular to:
   a. the content of the information, the separate annual report and the statements;
   b. the responsibility of the management board and supervisory board for compliance with the obligations;
   c. having the information, separate annual report and statements examined by an auditor or audit firm as referred to in Article 393 or by another third person or organisation and on the publication of the results of that examination;
   d. the manner of enforcement of the obligations;
   e. compliance with a code of conduct to be designated by the Order in council and on the content, disclosure and auditing of a corporate governance statement.
3. The nomination for an Order in council to be adopted pursuant to paragraph 1 shall not be made until four weeks after the draft has been submitted to both Houses of the States-General.
4. The draft of an Order in council to be adopted pursuant to paragraph 2 shall be submitted to both Houses of the States-General. The nomination for the Order in council to be adopted may be made after four weeks have passed since the submission, unless, within that period, a wish has been expressed by or on behalf of one of the Houses that the subject of the Order in council be regulated by law. In that case, a bill to that effect shall be submitted as soon as possible.
5. By regulation of Our Minister to whom it concerns, further rules may be given to implement binding EU legal acts, as referred to in the second paragraph, which may change regularly.

Part 8. Other information

Article 392

1. The management Board shall add the following information to the financial statements and the management board report:
   a. the auditor's opinion, as referred to in Article 393 paragraph 5 or a statement why this is not attached;
   b. a presentation of the statutory provisions concerning the appropriation of the profit;
   c. a presentation of the statutory provisions concerning the contribution to a deficit of a cooperative or mutual guarantee company, insofar as that deviates from the legal provisions;
   d. a list of names of persons /parties granted a special statutory right relating to the control in the entity, with a description of the nature of this right, unless such information is provided in the management board report pursuant to Article 391 paragraph 5;
   e. a statement of the number of non-voting shares and the number of shares that give limited or no rights to a share in the profit or reserves of the company, disclosing the relevant authorisations;
   f. a list of existing branch offices and the countries where there are branch offices, as well as their trade name if different from that of the entity.
2. The Other information shall not conflict with the financial statements and the management board report.
3. If a right as set out in paragraph 1, under d. is embodied in a share, the disclosure shall include the number of such shares held by each of the right holders. If such a right is held by a company, association, cooperative, mutual guarantee company or foundation, the names of the management board members thereof shall also be disclosed.
4. The provisions of paragraph 1 under d and in paragraph 3 are not applicable insofar Our Minister of Economic Affairs, upon request, has granted dispensation for justified reasons; such dispensation may be granted for a maximum of five years at a time. Dispensation from the provisions of paragraph 1 under d cannot be granted if such information shall be disclosed in the management board report pursuant to Article 391 paragraph 5.

5. The management board of a foundation or an association as set out in Article 360 paragraph 3 does not need to add the information set out in paragraph 1, under b, and Article 380c, to the financial statements and the management board report.

Part 9. Audit

Article 393

1. The entity shall grant an engagement for auditing the financial statements to a chartered accountant, to an accountant / administrative consultant with an annotation in the auditors' register as referred to in Article 36, second paragraph, part i, of the Auditors Profession Act (Wet op het accountantsberoep), or to a legal auditor as set out in Article 27, first paragraph, of the Audit Firm Supervision Act (Wet toezicht accountantsorganisaties). The assignment can also be granted to an organisation in which the above-mentioned auditors work together. If an entity is also a 'public interest entity' as referred to in Article 1, first paragraph, part l, of the Audit Firm Supervision Act, the entity shall notify the Financial Markets Authority (AFM) which auditor or audit firm is considered for performing the engagement of auditing the entity's financial statements. This notification shall be sent before the entity formally grants the engagement order as referred to in the second paragraph. Our Minister of Finance imposes further rules relating to this notification by ministerial regulation.
2. The general meeting is authorised to grant this engagement order. If the general meeting refrains from doing so, or does not exist, then the supervisory board is authorised. If a supervisory board does not exist, then the management board is authorised. Engaging the auditor is not limited by nominations. The audit engagement may be withdrawn by the general meeting and by the person that granted the engagement order. The audit engagement may be withdrawn exclusively for justified reasons; this does not include a difference of opinion concerning accounting methods or audit work. At the auditor's request, the general meeting shall allow the auditor a hearing, upon his request, concerning the withdrawal of the engagement granted or the intention to do so which has been communicated to him. The management board and the auditor shall immediately inform the Foundation Financial Markets Authority concerning the withdrawal of the engagement by the entity or the intermediate termination of the engagement by the auditor, providing adequate motivation.
3. The auditor shall examine whether the financial statements provide the insight required pursuant to Article 362 paragraph 1. Furthermore, the auditor shall ascertain that the financial statements comply with the provisions set out in legislation, that the management board report has been prepared in accordance with this title and that it is consistent with the financial statements, and whether the management board report contains any material misstatements in view of the knowledge and understanding of the entity and its environment obtained when auditing the financial statements, and that the information required pursuant to Article 392 paragraph 1, subs b up to and including f, has been added.
4. The auditor reports the findings of his audit to the supervisory board and the management. This at least includes reporting the findings concerning the reliability and continuity of the automated data processing.
5. The auditor shall present the outcome of his audit in a report concerning the true and fair view of the financial statements. The auditor may issue separate auditor's reports for the separate and the consolidated financial statements. The auditor's report shall at least include:
    a. a note identifying the financial statements that the audit relates to, and the legal provisions that apply to the financial statements;
    b. a description of the scope of the audit, stating at least the auditing standards observed;
    c. an opinion whether the financial statements provide the required insight and whether these comply with the rules set out in and pursuant to legislation;
    d. a reference to certain matters in respect of which the auditor draws particular attention, without issuing an auditor's opinion as set out in paragraph 6 sub b;
    e. a note relating to non-compliance issues identified in the examination in accordance with paragraph 3 whether the management board report was prepared in accordance with this title, and information required pursuant to Article 392 paragraph 1, subs b up to and including f, was added;
    f. an opinion concerning the consistency of the management board report with the financial statements;
    g. an opinion if any material misstatements were found in the management board report based on the knowledge and understanding of the entity and its environment obtained during the audit of the financial statements, setting out the nature of such misstatements;
    h. a statement relating to material uncertainties relating to events or circumstances that may give rise to reasonable doubt if the entity will be able to continue its operations;
    i. a note relating to the audit firm's statutory seat.

6. The auditor’s report as set out in paragraph 5, has the form of:
   a. an unqualified opinion;
   b. a qualified opinion;
   c. an adverse opinion; or
   d. a disclaimer of opinion.

   The auditor shall sign the auditor's report with the date and signature.
7. The financial statements cannot be adopted if the authorised body has not been able to review the auditor's report, unless a legal basis is reported in the Other information for the absence of the report.
8. Every stakeholder may demand the entity’s compliance with the obligation set out in paragraph 1.

Part 10. Publication

Article 394

1. The entity must publish the financial statements within eight days of their adoption. Publication shall be done by filing the financial statements, fully prepared in Dutch, or, if these have not been prepared, the financial statements in French, German or English, with the trade register of the Chamber of Commerce, if applicable or pursuant to or as set out in Article 19a of the 2007 Trade Register Act. The adoption date must be disclosed.
2. If the financial statements are not adopted within two months of the end of the legally required term for preparation, then the management board is required to publish the prepared financial statements immediately in accordance with the provisions of paragraph 1; the financial statements shall state that these have not yet been adopted. Within two months of judicial annulment of financial statements, the entity shall file a copy of the orders set out in the decision relating to the financial statements to the trade register, setting out the decision.
3. No later than twelve months after the end of the financial year, the entity shall have published the financial statements in the way set out in paragraph 1.
4. Simultaneous with and in the same way as the financial statements, the management board report and the other information referred to in Article 392 shall be published either in Dutch or in one of the other languages set out in the first paragraph. Excepting for the information set out in Article 392 paragraph 1 under a and e, the above does not apply if the documents are kept for public inspection at the office of the entity, providing a full or partial copy at request at no more than cost; the entity shall disclose this in its registration in the trade register.
5. The previous paragraphs do not apply if Our Minister of Economic Affairs has granted the dispensation referred to in Article 58, Article 101 or Article 210; in such an event, a copy of this dispensation is filed with the trade register.
6. The documents referred to in the previous paragraphs shall be filed for seven years. The Chamber of Commerce may transfer the information received in such documents to other data carriers to keep the information in the trade register in their place, provided that such transmission is done based on correct and complete inclusion of the data, ensuring that these data are available during the full retention period and can be made readable within a reasonable time.
7. Every stakeholder may demand the entity’s compliance with the obligations set out in paragraphs 1-5.
8. A company with securities admitted to trading on a regulated market as referred to in the Financial Supervision Act, is deemed to have complied with:
   a. paragraph 1, if, pursuant to Article 5:25o, first paragraph of that Act, the company sent the adopted financial statements to the Foundation Financial Markets Authority;
   b. paragraph 2, first sentence, if the company made the announcement pursuant to Article 5:25o, second paragraph, of that Act, to the Foundation Financial Markets Authority;
   c. fourth paragraph, first sentence, if the company sent the management board report and the other information referred to in Article 392 pursuant to Article 5:25o, fourth paragraph, of the Financial Supervision Act to the Foundation Financial Markets Authority.

Article 395

1. If the financial statements are published in a way other than pursuant to the previous Article, than in any case the auditor's report set out in Article 393 paragraph 5 shall be attached. For application of the previous sentence, the definition of financial statements of an entity within the scope of the provisions of Article 397 also includes the financial statements in the form in which it may be published pursuant to this Article. If the audit opinion was not issued, the reason therefor shall be disclosed.
2. If only the balance sheet or the profit and loss account, with or without the notes, or if the financial statements

are summarised and published in any form other than pursuant to the previous Article, the entity shall unambiguously disclose this with reference to the publication pursuant to legal requirements, or, if this was not done, by stating this fact. The auditor’s report set out in Article 393 paragraph 5 shall not be attached in that case. The publication shall disclose if the auditor has issued such auditor’s report. If the auditor’s report was issued, the nature of the auditor’s report as set out in Article 393 paragraph 6 shall be reported. Also, the entity shall disclose if the auditor has drawn particular attention to certain matters in the auditor's report, without issuing an auditor’s report as referred to in Article 393 paragraph 6, part b. If the auditor’s report was not issued, the reason therefor shall be reported.

3. If the financial statements have not yet been adopted, this shall be stated in the documents set out in paragraphs 1 and 2. If a disclosure has been made as referred to in the last sentence of Article 362 paragraph 6, this shall also be disclosed.

Part 11. Exemptions based on the scale of the entity’s operations

Article 395a

1. Paragraphs 3 up to and including 6 apply to an entity that has met two or three of the requirements below on two consecutive balance sheet dates, without subsequent interruption for two consecutive balance sheet dates:
   a. the value of the assets according to the balance sheet and the notes, on the basis of acquisition and manufacturing cost, amounts to no more than € 350,000;
   b. the net turnover for the financial year amounts to no more than € 700,000;
   c. the average number of employees during the financial year is less than 10.
2. For the application of paragraph 1, the value of the assets, the net turnover and the number of employees of group companies that should be consolidated if the entity would have to prepare consolidated financial statements, shall be factored in. This does not apply if the entity applies Article 408.
3. The provisions of paragraphs 3 and 4 of Article 364 pertaining to the prepayments and accrued income and accruals and deferred income are not applicable for the other operating costs as set out in Article 377 paragraph 3 under j. The entity discloses that no prepayments and accrued income and accruals and deferred income are recognised at the bottom of the balance sheet.
4. Relating to the disclosures required pursuant to Part 3, no other disclosures are required other than those set out in the Articles 364 paragraph 1, 365 paragraph 1 under a and 370 paragraph 1 under d, 373 paragraph 1 where items are merged into a single item, 374 paragraph 1 and 375 paragraph 1 where items are merged into a single item and where for the total of the debts is disclosed the amount with a remaining term up to one year, and the amount with a remaining term more than one year. Furthermore, a public limited liability company shall disclose the information set out in the second sentence of Article 378 paragraph 3 at the bottom of the balance sheet.
5. Relating to the disclosures required pursuant to Part 4, no other disclosures are required in addition to those set out in the Articles 377 paragraph 1 under a, with the exception of disclosing the income and expenses from ordinary operations, 377 paragraph 3 under a, d and e, 377 paragraph 3 under g, with the exception of the disclosure of the other external costs, 377 paragraph 3 under h and i, where items are merged into a single item, and 377 paragraph 3 under j.
6. Part 5, the provisions of Part 6 relevant to the required disclosures in the notes, and Parts 7, 8 and 9 are not applicable.
7. In derogation of Part 6 of this title, for the measurement of assets and liabilities and for determination of the profit or loss, the accounting policies for determining the taxable profit as set out in Chapter II of the 1969 Corporate Income Tax Act may also be applied, provided that the entity applies all tax policies applicable to it. If the entity applies these accounting policies, it shall disclose this accordingly in the notes. Further rules may be imposed by general administrative order relating to the use of these accounting policies and the related disclosures.
8. Article 394 is applicable only with respect to a short-form balance sheet as set out in paragraph 3 and 4.

Article 396

1. Without prejudice to Article 395a, paragraphs 3 up to and including 9 apply to an entity that has met at least two of the three following requirements on two consecutive balance sheet dates, without subsequent interruption for two consecutive balance sheet dates:
   a. the value of the assets according to the balance sheet and the notes, on the basis of acquisition and manufacturing cost, amounts to no more than € 6,000,000;
   b. the net turnover for the financial year amounts to no more than € 12,000,000;

    c. the average number of employees during the financial year is less than 50.
2. For the application of paragraph 1, the value of the assets, the net turnover and the number of employees of group companies that should be consolidated if the entity would have to prepare consolidated financial statements, shall be factored in. This does not apply if the entity applies Article 408.
3. Relating to the disclosures required pursuant to Part 3, no other disclosures are required other than those set out in Articles 364, 365 paragraph 1 under a, 368 paragraph 2 under a, 370 paragraph 1 under d, 373 paragraphs 1 up to and including 5, first sentence, 375 paragraph 3 and 376, and, without specification per type of debt or receivable, in Articles 370 paragraph 2 and 375 paragraph 2, where the interest rate is not disclosed, and the disclosure of the retained portion of the profit or loss.
4. In the profit and loss account, the items set out in Article 377 paragraph 3 under a-d and g, respectively paragraph 4 under a-c and f, are combined into a single item called gross operating profit or loss.
5. The statement as referred to in Article 378 paragraph 1 is provided only for the revaluation reserve, excepting for the second sentence of Article 378 paragraph 3. Articles 379, 380, 381 paragraphs 2 and 3, 381b, preamble and under a, 382a and 383 paragraph 1 are not applicable. The entity shall disclose the name and address of the company preparing the consolidated financial statements of the part of the group to which the entity belongs. The information disclosed pursuant to Article 382 is limited to stating the average number of employees working for the entity during the financial year.
6. In derogation of Part 6 of this title, for the measurement of assets and liabilities and for determination of the profit or loss, the accounting policies for determining the taxable profit as set out in Chapter II of the 1969 Corporate Income Tax Act may also be applied, provided that the entity applies all tax policies applicable to it. If the entity applies these accounting policies, it shall disclose this accordingly in the notes. Further rules may be imposed by general administrative order relating to the use of these accounting policies and the related disclosures.
7. Articles 380c and 380d, 383b up to and including 383e, 391, 392 and 393 paragraph 1 are not applicable.
8. Article 394 is applicable only with respect to a short-form balance sheet and the notes as set out in paragraph 3. In the published notes, the information as referred to in Article 380a is omitted.
9. If the entity is a not-for-profit organisation, application of Article 394 is not mandatory provided that
    a. the documents referred to in paragraph 8 are sent to creditors and holders of shares or certificates of shares in its capital, or to others entitled to attend meetings, such at first request and free of charge, or made available for inspection at the office of the entity; and
    b. a report from an auditor is filed at the trade register, stating that the entity has carried out no work during the financial year outside the definition of purpose and that this Article applies to it.

Article 397

1. Except Article 396, paragraphs 3 up to and including 7 apply to an entity that has met two or three of the following requirements on two consecutive balance sheet dates, without subsequent interruption for two consecutive balance sheet dates:
    a. the value of the assets according to the balance sheet and the notes, on the basis of acquisition and manufacturing cost, amounts to no more than € 20,000,000;
    b. the net turnover for the financial year amounts to no more than € 40,000,000;
    c. the average number of employees during the financial year is less than 250.
2. For the application of paragraph 1, the value of the assets, the net turnover and the number of employees of group companies that should be consolidated if the entity would have to prepare consolidated financial statements, shall be factored in. This does not apply if the entity applies Article 408.
3. In the profit and loss account, the items referred to in Article 377 paragraph 3, under a–d and g, respectively paragraph 4, under a–c and f, are combined into a single item called gross operating profit or loss; the entity discloses in a ratio the increase or decrease of net turnover compared with that in the previous financial year.
4. Articles 380c and 382a are not applicable.
5. Of the disclosures set out in part 3, the published balance sheet and the notes shall disclose only those required pursuant to Article 364, 365 paragraph 1 under a and d, 366, 367 under a–d, 368 paragraph 2 under a, 370 paragraph 1 under b–d, 373, 374 paragraphs 3 and 4, 375 paragraph 1 under a, b, f and g and paragraph 3, and 376 and the accruals. The paragraphs 2 of Article 370 and 375 shall be applicable both to the total sum of receivables and debts and to the items set out in paragraph 1 of those Articles that shall be stated separately. The profit and loss account and the notes to be published may be limited in accordance with paragraphs 3 and 4.
6. The information to be disclosed pursuant to Article 381 paragraph 2 is limited to information relating to the nature and business purpose of the relevant arrangements. Article 381 paragraph 3 is not applicable, unless the

entity is a public limited liability company. In that event, the disclosure set out in Article 381 paragraph 3 is limited to transactions entered into, directly or indirectly, between the company and its key shareholders and between the company and its management board and supervisory board members.
7. The information set out in Article 392 paragraph 1, subs d and e, and paragraph 3, is not published.
8. The management board report does not need to set out non-financial performance indicators as referred to in Article 391 paragraph 1.

Article 398

1. Article 395a, Article 396 or Article 397 shall also apply in the first and second financial year to an entity that met the relevant requirements as at balance sheet date of the first financial year.
2. Article 395a paragraphs 3 up to and including 7, Article 396 paragraphs 3 up to and including 8 and Article 397 paragraphs 3 up to and including 7 apply insofar the general meeting has not decided otherwise no later than six months from the beginning of the financial year.
3. The Articles 395a up to and including 397 are not applicable to an investment company or company for collective investment in securities that is subject to Article 401 paragraph 1.
4. The amounts referred to in Article 396 paragraph 1 and Article 397 paragraph 1 shall be decreased by a general administrative order if this is a legal requirement pursuant to legislation of the European Communities, and may be increased insofar permitted by law.
5. Application of Article 396 paragraph 1 and 397 paragraph 1 on a foundation or association as set out in Article 360 paragraph 3 shall be based on the sum of assets of the foundation or association and, observing the provisions of Article 396 paragraph 2, of the net turnover and the average number of employees of the business or businesses maintained by this foundation or association.
6. Article 395a is not applicable to a participation company as referred to in article 2, Part 15 of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the financial statements, consolidated financial statements and associated reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC of the Council (*OJEU* 2013, L 182).
7. Articles 395a up to and including 397 are not applicable to entities that are a public interest entity and:
   a. have securities admitted to trading on a regulated market of a member state in the sense of Article 4, paragraph 1, item 14 of Directive 2004/39/EC of the European Parliament and the Commission of 21 April 2004 regarding markets for financial instruments (*OJEU* 2004, L 145);
   b. credit institutions in the sense of Article 3, item 1 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (*OJEU* 2013, L 176), and that are not institutions as referred to in Article 2, paragraph 5, of the above- mentioned Directive 2013/36/EU;
   c. insurance companies in the sense of Article 2, paragraph 1 of Directive 91/674/EEC of the Council of 19 December 1991 on the financial statements of insurance companies (OJEC 1991, L 374); or
   d. entities that were designated based on a general administrative order due to their size or public interest function.

Part 12. Provisions relating to entities of different forms

Article 399

(lapsed)

Article 400

Whether or not under certain conditions, our Minister of Finance may permit financial institutions that are not a bank as set out in Article 415, at the entity’s request, to apply Part 14, with the exception of Article 424.

Article 401

1. A manager of an investment institution, a manager of an ICBE (UCITS), an investment company and a company for collective investment in securities to which the Title Supervision of Conduct of financial companies of the Financial supervision act (Wft) applies, shall, in addition to the provisions of this title, also comply with the requirements in respect of its financial statements pursuant to or set out in that legislation. For such a manager of an investment institution, a manager of an ICBE (UCITS), an investment company and a company for collective investment in securities, derogation from Articles 394, paragraph 2, 3 or 4, and 403 is possible

pursuant to or as set out in that legislation.
2. The investments of an investment company or a company for collective investment in securities as set out in Article 1:1 of the Wft may be measured at market value. Unfavourable price differences compared with the previous balance sheet date do not need to be charged to the profit and loss account, provided that these are charged to the reserves; favourable price differences may be added to the reserves. The amounts shall be stated in the balance sheet or the notes.
3. An investment company with variable capital is not subject to Article 378 paragraph 3, second sentence.

Article 402

1. If the financial information of an entity is included in its consolidated financial statements, the separate profit and loss account needs only to present the profit or loss from participating interests after deduction of the relevant taxes as a separate item. The application of the previous sentence shall be disclosed in the notes to the consolidated financial statements.
2. This Article does not apply to entities as referred to in Article 398 paragraph 7.

Article 403

1. An entity that is part of a group is not required to prepare its financial statements according to the provisions of this Title, provided that:
   a. the balance sheet at least presents the sum of the fixed assets, the sum of the current assets and the amount of the equity, of the provisions and the debts, and the profit and loss account shall at least present the profit or loss from ordinary operations and the balance of the other income and expenses, such after taxes;
   b. the members or shareholders have declared in writing after the commencement of the financial year and before the adoption of the financial statements to consent to the derogation;
   c. the financial information of the entity is consolidated by another entity or company in consolidated financial statements to which, pursuant to applicable law, the directive of the European Parliament and the Commission concerning the application of international standards for financial statements, directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the financial statements, consolidated financial statements and associated reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC of the Council (*OJEU* 2013, L 182), or one of the two directives of the Council of the European Communities concerning the financial statements and the consolidated financial statements of banks and other financial institutions or insurance companies apply;
   d. the consolidated financial statements, insofar not prepared in or translated into Dutch, shall be prepared in or translated into French, German or English;
   e. the auditor's report and the management board report shall be prepared in or translated into the same language as the consolidated financial statements;
   f. the entity or company referred to under c. has declared in writing that it assumes joint and several liability for the debts arising from the legal acts of the entity; and
   g. the statements referred to in subs b and f are filed with the trade register, and also, such within six months after the balance sheet date or within one month after a permitted later publication, the documents or translations referred to in subs d and e.
2. If, within the group or part of the group of which the information is included in the consolidated financial statements, the entity or company as set out in paragraph 1 under f and another entity or company are at the same level, paragraph 1 is applicable only if such other entity or company has also filed a declaration of liability; in this event, paragraph 1 under g and Article 404 are similarly applicable.
3. For an entity that is subject to paragraph 1, the Articles 391 up to and including 394 do not apply.
4. This Article does not apply to entities as referred to in Article 398 paragraph 7.

Article 404

1. A declaration of assumption of liability as set out in Article 403 may be withdrawn by filing a declaration to that effect with the trade register.
2. However, the liability shall continue for debts arising from legal actions that were performed before the withdrawal could be invoked against the creditor.
3. The remaining liability towards the creditor is ceased if the following conditions are met:
   a. the entity is no longer part of the group;
   b. an announcement concerning the intention to terminate has been available for inspection at the trade

    register for at least two months;
   c. at least two months have passed since the announcement in a national daily newspaper that and where the announcement is available for inspection;
   d. the creditor has not opposed the intention in due order or has not withdrawn the opposition, nor has the withdrawal been declared unfounded by an irrevocable judicial decision.
4. If the creditor so demands, he shall be provided with security or otherwise given a guarantee for the satisfaction of his claims for which liability still remains, failing which the opposition referred to in paragraph 5 shall be upheld. This does not apply if after the liability has ceased, this creditor has sufficient guarantees that such claims will be satisfied based on the entity's financial position or for other reasons.
5. Up to two months of the announcement, the creditor in respect of whose claim liability still remains, may oppose the intention to terminate by filing a petition with the district court of the place of residence of the entity that is the principal obligor.
6. The court shall only declare the opposition well-founded after the term specified by the court to provide a specific guarantee has expired without the guarantee having been provided.

Article 404a
(lapsed)

Part 13. Consolidated financial statements

Article 405

1. Consolidated financial statements are the financial statements in which the assets, liabilities, income and expenses of the entities and companies that form a group or part of a group, and other consolidated entities and companies, are presented on a unified basis.
2. The consolidated financial statements shall provide insight into the entire set of consolidated entities and companies, such in accordance with Article 362 paragraph 1.

Article 406

1. A entity that, solely or jointly with another group company, is the head of its group, shall prepare consolidated financial statements, which shall include its own financial information together with that of its subsidiaries in the group, other group companies and other entities that it can control or that are centrally managed by the entity.
2. A entity to which paragraph 1 does not apply, but that has in its group one or more subsidiaries or other entities that it can control or that are centrally managed by the entity, shall prepare consolidated financial statements. These shall include the financial information of the part of the group, consisting of the entity, its subsidiaries in the group, other group companies that fall under this entity, and any other entities that it can control or that are centrally managed by it.
3. A entity that is not a bank as set out in Article 415 and of which the consolidated financial statements contain, for a significant part, financial information of one or more banks, shall at least provide insight in the notes into the solvency of the banks as a whole.
4. A entity that is not an insurance company as set out in Article 427 paragraph 1 and for which the consolidated financial statements contain, for a significant part, financial information of one or more insurance companies, shall at least provide insight in the notes into the solvency of the insurance companies as a whole.
5. In the consolidated financial statements of an entity that is not a bank as set out in Article 415, Article 424 may be applied for companies to be included in the consolidation that are a bank, together with the companies referred to in Article 426 paragraph 1.

Article 407

1. The consolidation requirement does not apply for information of:
   a. companies to be included in the consolidation of which the combined significance is negligible compared to the whole;
   b. companies to be included in the consolidation for which the necessary information can only be obtained or estimated at disproportionate cost or with substantial delay,
   c. companies to be included in the consolidation in which the company holds an interest for disposal only.
2. Consolidation is not required if
   a. on consolidation, the limits set out in Article 396 would not be exceeded;
   b. none of the companies to be included in the consolidation is an entity as referred to in Article 398 paragraph 7;

c. the entity has not been notified in writing of an objection thereto by the general meeting within six months from the commencement of the financial year.

3. If an entity manages group companies pursuant to a cooperation arrangement with another entity, the financial information of which is not included in its consolidated financial statements, it may omit its own financial information from the consolidated financial statements. This shall apply only if the entity does not have any activities other than managing and financing group companies and participating interests, and if it applies Article 389 in its balance sheet.

Article 408

1. Consolidation of a part of a group is not required, on the condition that:
   a. the entity has not been notified in writing of an objection thereto by at least one tenth of the members or by holders of at least one tenth of the issued share capital within six months from the commencement of the financial year;
   b. the financial information that the entity should consolidate is included in the consolidated financial statements of a larger entity;
   c. the consolidated financial statements and the management board report have been prepared in accordance with the provisions of directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the financial statements, consolidated financial statements and associated reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC of the Council (*OJEU* 2013, L 182), or in accordance with the provisions of one of the directives of the Council of the European Community on the financial statements and consolidated financial statements of banks and other financial institutions and/or insurance companies, and/or, if these provisions need not to be observed, in an equivalent manner;
   d. the consolidated financial statements with auditor's report and management board report, insofar as not prepared in or translated into Dutch, are prepared in or translated into French, German or English, all in the same language; and
   e. the documents or translations referred to in subs d and e are filed within six months after the balance sheet date or within one month after a permitted later publication with the trade register.
2. Our Minister of Justice may designate instructions for the financial statements, if necessary with additional provisions provided, that will be considered as equivalent to provisions in accordance with directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the financial statements, consolidated financial statements and associated reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC of the Council (*OJEU* 2013, L 182). Withdrawal of such a designation can only relate to financial years that have not yet started.
3. The entity shall disclose the application of paragraph 1 in the notes.
4. This Article is not applicable to an entity with securities admitted to trading on a regulated market as referred to in the Wft (Financial Supervision Act), or a system equivalent to a regulated market in a non-member state.

Article 409

The financial information of an entity or company may be included in the consolidated financial statements in proportion to the interest held, if

a. in this entity or company, one or more companies included in the consolidation are able to jointly exercise the rights or powers referred to in Article 24a, paragraph 1, pursuant to an arrangement for cooperation with other shareholders, members or partners; and
b. if this meets the legally required insight.

Article 410

1. The provisions of this title on the financial statements and its components are similarly applicable to the consolidated financial statements, with the exception of Articles 365 paragraph 2, 378, 379, 382a, 383, 383b up to and including 383e, 389 paragraphs 6 and 8, and 390.
2. Inventories need not be specified, if this would involve disproportionate costs due to special circumstances.
3. Other measurement methods and policies for the determination of the profit or loss than those applied in the entity’s separate financial statements may be applied for well-founded reasons to be disclosed in the notes.
4. If a foreign entity jointly heads the group, the part of the group of which it is the head may be consolidated in accordance with its law, disclosing the impact thereof on the equity and profit or loss.
5. The information set out in Article 382 shall be disclosed in total for the fully consolidated companies; the

information referred to in the first sentence of Article 382 shall be disclosed separately in total for the proportionally consolidated companies.

Article 411

1. The equity does not need to be specified in the consolidated financial statements.
2. The share in the group equity and in the consolidated profit or loss that does not accrue to the entity, is disclosed.

Article 412

1. The balance sheet date for the consolidated financial statements shall be the same as for the separate financial statements of the entity.
2. The consolidated financial statements shall in no event be prepared based on information recognised more than three months before or after balance sheet date.

Article 413

If the information of a company is included in the consolidation for the first time, and a difference in value arises compared with the previous measurement of the interest in this company, this difference and the calculation method must be disclosed. If the value is lower, Article 389 paragraph 7 shall apply to the difference; if the value is higher, the difference is recognised in group equity, insofar this does not reflect any disadvantages associated with the participating interest.

Article 414

1. The entity discloses, specified for the following categories, the name and place of residence of entities and companies:
    a. that are fully consolidated in the entity's consolidated financial statements;
    b. for which financial information is included in the consolidated financial statements for a portion proportionate to the relevant interest in the entity;
    c. in which a participating interest is held that is accounted for in the consolidated financial statements pursuant to Article 389;
    d. that are a subsidiary without legal personality and are not disclosed pursuant to the items a, b or c;
    e. in which one or more fully consolidated companies or subsidiaries thereof, solely or jointly for their own account, contribute, directly or indirectly, at least one fifth of the issued capital and that are not disclosed pursuant to the items a, b or c.
2. The following shall also be disclosed:
    a. pursuant to which circumstances each company is fully included in the consolidation, unless this is based on being able to exercise the majority of the voting rights and the contribution of a corresponding part of the capital;
    b. the basis of the eligibility of an entity or company for which financial information is included in the consolidated financial statements pursuant to Article 409;
    c. if applicable, the reason for not consolidating a subsidiary, disclosed pursuant to paragraph 1 under c, d or e;
    d. the part of the issued capital contributed;
    e. the amount of the equity and profit or loss of each company disclosed pursuant to paragraph 1 under e, according to its most recently adopted financial statements.
3. If disclosure of the name, place of residence and the interest held in the issued capital of a subsidiary to which the provisions of paragraph 1 under c. apply, is beneficial to the legally required insight, such disclosure may not be omitted, even if this concerns a participating interest of negligible significance. Paragraph 2, under e, does not apply to companies in which an interest of less than one half is held and that lawfully do not publish the balance sheet.
4. Article 379 paragraph 4 is similarly applicable to the disclosures pursuant to paragraphs 1 and 2.
5. The entities for which a declaration of assumption of liability was issued in accordance with Article 403 shall be disclosed.

Annex 2 Some provisions of Book 2 NCC

TITLE 1. General provisions

Article 10

1. The management board is obliged to keep records of the financial position of the entity and of everything concerning the activities of the entity, in accordance with the requirements arising from these activities, and to keep the books, documents and other data carriers in such a way that the rights and obligations of the entity can be known at any time.
2. Without prejudice to the provisions in the following titles, the management board is obliged to prepare on paper the balance sheet and the statement of income and expenses of the entity within 6 months after the end of the financial year.
3. The management board is obliged to keep the books, documents and other data carriers referred to in paragraphs 1 and 2 for seven years.
4. The data entered into a data carrier, except for the balance sheet and statement of income and expenses set out on paper, may be transferred to another data carrier and stored, provided that the transfer is effected with a correct and full presentation of the data and these data are available during the full retention period and can be made readable within reasonable time.

Article 10a

The financial year of an entity is equal to the calendar year, unless a different financial year is designated in the Articles of Association.

Article 24a

1. A subsidiary of an entity is:
   a. an entity in which the entity or one or more of its subsidiaries, whether or not based on an agreement with other voting right holders, are able to solely or jointly exercise more than half of the voting rights in the general meeting;
   b. an entity in which the entity or one or more of its subsidiaries are a member or shareholder and, whether or not based on an agreement with other voting right holders, is able to solely or jointly appoint or dismiss more than half of the members of the management board or the supervisory board, even if all vote holders are voting.
2. Equivalent to a subsidiary is a company acting in its own name in which the entity or one or more of its subsidiaries is a partner and fully liable towards the creditors for the debts.
3. For the application of paragraph 1, the rights associated with shares shall not be allocated to the party holding the shares for the account of another party. Rights related to the shares shall be assigned to the party for which account such shares are held, if authorised to determine how the rights are exercised or to claim the shares.
4. Relating to application of paragraph 1, voting rights associated with pledged shares shall be assigned to the pledge holder if the pledge holder can determine how to exercise the rights. However, if such shares were pledged for a loan that the pledge holder has granted in the ordinary course of his business, the voting rights shall be allocated to the pledge holder only if such rights have been exercised in the pledge holder’s interest.

Article 24b

A group is an economic entity in which entities and companies are organisationally interconnected. Group companies are entities and companies that are interconnected in a group.

Article 24c

1. A entity or company has a participating interest in an entity if it or one or more of its subsidiaries, solely or jointly, for their own account contribute or arrange to contribute capital to such entity in order to ensure long-term association with such entity to support its own activities. If at least one fifth of the issued capital is contributed, it is presumed that a participating interest exists.
2. A entity has a participating interest in a company if the entity or a subsidiary:
   a. is, as a partner, fully liable for the entity’s debts towards the creditors; or
   b. is a partner otherwise based on a long-term commitment to serving the entity’s own activities.

Article 24d

1. When determining what percentage of members or shareholders are voting, attending or represented, or which percentage of the share capital is contributed or represented, no account shall be taken of memberships or shares in respect of which the law or a statutory arrangement as set out in Article 228 paragraph 5 provide that no vote may be cast.
2. In derogation of paragraph 1, relating to the application of Articles 24c, 63a, 152, 201a, 220, 224a, 262, 265a, 333a paragraph 2, 334ii paragraph 2, 336 paragraph 1, 346, 379 paragraphs 1 and 2, 407 paragraph 2, 408 paragraph 1 and 414 with respect to a private limited liability company, account shall be taken of shares designated by a statutory arrangement as set out in Article 228 paragraph 5 that no vote can be cast.

TITLE 4. Public limited liability entities

Part 3. The equity of the public limited liability entity

Article 101

1. Each year within five months after the end of the company's financial year, excepting if an extension of this term is granted by the general meeting by a maximum of five months based on special circumstances, the management board shall prepare financial statements and shall make these available to the shareholders at the company's office. If this company's securities are admitted to trading on a regulated market as set out in the Financial Supervision Act, the term is four months, unless Article 5:25g, second or third paragraph of that Act is applicable. This term cannot be extended. Within this term, the management shall also make the management board report available to the shareholders, unless Articles 396 paragraph 7 or 403 apply to the entity. The management board of the company to which Articles 158 up to and including 161 and 164 apply, shall also send the financial statements to the Works Council as referred to in Article 158 paragraph 11.
2. The financial statements shall be signed by the management board members and the supervisory board members; if the signature of one or more such members is missing, this shall be disclosed with a justified reason.
3. The financial statements shall be adopted by the general meeting. Adoption of the financial statements does not equate discharge of a management board member respectively supervisory board member.
4. Resolutions concerning adoption of the financial statements shall not be subject to approval of a company body or third-party body pursuant to the Articles of Association.
5. The Articles of Association shall not set out any provisions allowing for rules or binding proposals for the financial statements or any items.
6. The Articles of Association may set out that a company body other than the general meeting is authorised to determine which part of the financial year's profit or loss will be reserved or how the loss will be allocated.
7. Our Minister of Economic Affairs and Climate may grant dispensation for justified reasons from the preparation, the submission and the adoption of the financial statements. No dispensation can be granted relating to preparing the financial statements of a company with securities admitted to trading on a regulated market as referred to in the Wft (Financial Supervision Act).

Article 102

1. The public limited liability company shall ensure that the prepared financial statements, the management board report and the information to be attached pursuant to Article 392 paragraph 1 are available at the entity's office from the date of convocation for the general meeting at which the documents are to be considered. The holders of its shares or certificates of shares issued with the entity's cooperation can view the documents there and receive a copy free of charge.
2. If such shares or certificates of shares are made out to bearer, or if the company has issued debt notes to bearer, then anyone may access the documents insofar these must be made available to the public upon adoption, and receive a copy at no more than cost. This entitlement shall lapse upon filing such documents with the trade register.

Article 104

A deficit may be charged to the legal reserves only to the extent permitted by law.

Article 105

1. Unless the Articles of Association determine otherwise, the profit is allocated to the shareholders.
2. The public limited liability company may distribute payments to the shareholders and other beneficiaries from

the profit available for distribution only insofar its equity exceeds the amount of the paid-up and called portion of the capital plus the reserves that shall be recognised pursuant to the law or the Articles of Association.
3. Distribution of profit takes place after adoption of the financial statements from which it appears that the same is permitted.
4. The company may make interim distributions only if permitted by the Articles of Association and if the requirement of the second paragraph was met based on an interim statement of assets and liabilities. This shall concern the position of the equity at the earliest on the first day of the third month prior to the month in which the distribution resolution was announced. This is prepared in accordance with generally acceptable measurement methods. The statement of assets and liabilities shall present the amounts of the reserves required by law or by the Articles of Association. It shall be signed by the management board members; if the signature of one or more such members is missing, this shall be disclosed with the justified reason. The company shall submit the statement of assets and liabilities to the trade register within eight days of the day of announcing the distribution resolution.
5. For the calculation of the profit appropriation, the shares held by the company in its own capital shall be included, unless determined otherwise in the Articles of Association.
6. For the calculation of the profit to be distributed on each share, only the amount of the mandatory payments on the nominal amount of the shares shall be included, unless determined otherwise in the Articles of Association.
7. The Articles of Association may set out that the claim of a shareholder does not expire after five years, but only after a longer term. Such a provision shall be similarly applicable to a claim of the holder of certificates of shares on the shareholder.
8. A distribution that does not comply with the second or fourth paragraph shall be repaid by the shareholder or other beneficiary that knew or could be expected to know that the payment was not permitted.
9. None of the shareholders can be fully excluded from sharing in the profit.
10. The Articles of Association may set out that all or some of the profits to which holders of a particular class of shares are eligible shall be reserved, in full or in part, for their benefit.

TITLE 5. Private limited liability entities

Part 3. The equity of the public limited liability entity

Article 210

1. Each year within five months after the end of the company's financial year, excepting if an extension of this term is granted by the general meeting by a maximum of five months based on special circumstances, the management board shall prepare financial statements and shall make these available to the shareholders at the company's office. If this company's securities are admitted to trading on a regulated market as set out in the Financial Supervision Act, the term is four months, unless Article 5:25g, second or third paragraph of that Act is applicable. This term cannot be extended. Within this term, the management shall also make the management board report available to the shareholders, unless Articles 396 paragraph 7 or 403 apply to the entity. The management board of the company to which Articles 268 up to and including 271 and 274 apply, shall also send the financial statements to the Works Council as referred to in Article 268 paragraph 11.
2. The financial statements shall be signed by the management board members and the supervisory board members; if the signature of one or more such members is missing, this shall be disclosed with a justified reason.
3. The financial statements shall be adopted by the general meeting. Adoption of the financial statements does not equate discharge of a management board member respectively supervisory board member.
4. Resolutions concerning adoption of the financial statements shall not be subject to approval of a company body or third-party body pursuant to the Articles of Association.
5. If all shareholders of a company are also a management board member of the company, signing the financial statements by all management board members and supervisory board members also applies as adoption in the sense of paragraph 3, provided that all the other persons entitled to attend the meetings were given the opportunity to review the prepared financial statements and have agreed with this adoption method as set out in Article 238 paragraph 1. In derogation of paragraph 3, this adoption shall also constitute a discharge for the management board members and supervisory board members. The Articles of Association may exclude the adoption method for the financial statements as set out in the first sentence.
6. The Articles of Association shall not set out any provisions allowing for rules or binding proposals for the financial statements or any items.
7. The Articles of Association may set out that a company body other than the general meeting is authorised to

determine which part of the financial year's profit or loss will be reserved or how the loss shall be allocated.

8. Our Minister of Economic Affairs and Climate may grant dispensation for justified reasons for the preparation, the submission and the adoption of the financial statements. No dispensation can be granted relating to preparing the financial statements of a company with securities admitted to trading on a regulated market as referred to in the Wft (Financial Supervision Act).

Article 212

The company shall ensure that the prepared financial statements, the management board report and the information to be attached pursuant to Article 392 paragraph 1 are available at the entity's office from the date of convocation for the general meeting at which the documents are to be considered. The shareholders and other entitled attendants can view the documents there and receive a copy free of charge.

Article 215

A deficit may be charged to the legal reserves only to the extent permitted by law.

Article 216

1. The general meeting is authorised to appropriate the profit that has been determined by adopting the financial statements and to decide to make distributions, to the extent that the equity exceeds the reserves that must be maintained pursuant to the law or the Articles of Association. The Articles of Association may restrict the authorisations referred to in the first sentence or assign such authorisations to a different body.
2. A resolution to make a distribution has no implications as long as the board has not granted its approval. The management board shall refuse its approval only if it knows or could reasonably foresee that after such distribution the company will not be able to continue to pay its due and payable debts.
3. If the company is unable to continue to pay its due and payable debts after a distribution, the management board members who knew this, or could reasonably have foreseen this at the time of distribution, shall be jointly and severally liable toward the company for the shortfall which results from such distribution, plus the amount of statutory interest from the day of distribution. Article 248 paragraph 5 is similarly applicable. Not liable is a board member proving that the distribution by the company is not attributable to him/her, and that he/she was not negligent in imposing measures to avert the consequences. A person who received a payment while he/she knew, or could reasonably foresee that the company would be unable to continue to pay its due and payable debts, is liable for compensating the shortfall resulting from the distribution, each such person for a maximum of the amount or value of the distribution he/she received plus the amount of statutory interest from the day of distribution. If the management board members have settled the claim pursuant to the first sentence, the compensation set out in the fourth sentence shall be given to the management board members pro rata to the part settled by each of the management board members. Relating to a debt pursuant to the first or fourth sentence, the debtor is not authorised to offsetting.
4. In the context of application of paragraph 3, a person who has determined or co-determined the company's policy as if he/she were a management board member shall be equated to a management board member. The claim cannot be submitted to the administrator appointed by the court.
5. For the calculation of each distribution, the shares that the company holds in its own capital shall not be included, unless determined otherwise in the Articles of Association.
6. The calculation of the amount to be distributed on each share shall be based only on the amount of the mandatory payments on the nominal value of the shares. Derogation of the previous sentence is permitted based on provisions in the Articles of Association or based on the consent of all shareholders.
7. The Articles of Association may set out that shares of a certain class or type may give limited or no rights to a share in the profit or reserves of the company.
8. A statutory arrangement as set out in paragraphs 6 or 7 is subject to consent of all holders of shares whose rights would be affected by the amendment to the Articles of Association.
9. The Articles of Association may set out that the claim of a shareholder does not expire after five years, but only after a longer term. Such a provision shall be similarly applicable to a claim of the holder of certificates of shares on the shareholder.
10. The Articles of Association may set out that all or some of the profits to which holders of a particular class of shares are eligible shall be reserved, in full or in part, for their benefit.
11. Paragraph 3 is not applicable to distributions in the form of shares in the company's capital or to deposits on shares that are not fully paid up.

Annex 3 Decree on current value

Art. 1

1. The term current value of assets and liabilities is understood to mean the value which is based on current market prices or on data which can be considered to be relevant to the value on the date of valuation.
2. As current value at which assets and liabilities can be measured in the financial statements are eligible, depending on the type of assets or liabilities or on circumstances, the current cost, value in use, market value or net realisable value.

Art. 2

The current cost is understood to mean:

a. the current purchase price and additional costs of an asset, less depreciations; or
b. the current acquisition cost of the raw materials and supplies used and the other costs which can be attributed directly to the manufacture of an asset, less depreciations. These costs may include a reasonable portion of the indirect costs and the interest on debts over the period that can be attributed to the manufacture of the asset.

Art. 3

The value in use is understood to mean the present value of the estimated future cash flows attributable to an asset or combination of assets which can be obtained through the conduct of business.

Art. 4

The market value is understood to mean the amount for which an asset can be traded or a liability can be settled between knowledgeable, willing parties in an arm’s length transaction.

Art. 5

The net realisable value is understood to mean the maximum amount for which an asset can be sold, less the costs still to be incurred.

Art. 5a

Measurement at market value is not permitted for an entity as referred to in Article 395a of Book 2 NCC.

Art. 6

An intangible fixed asset can only be measured at current value if:

a. the asset was recognised in the balance sheet at cost from the date of acquisition; and
b. an active market exists for the asset.

Art. 7

If tangible fixed assets or intangible fixed assets, other than investments, are measured at current value, the current cost is eligible for that. Measurement takes place at the value in use if this is lower than the current cost. If the net realisable value is lower than the current cost and higher than the value in use, the measurement will take place at net realisable value.

Art. 8

If agricultural inventories are measured at current value, the net realisable value is eligible for those.

Art. 9

It shall be explained in the notes how the current cost, value in use or net realisable value, referred to in the Articles 7 and 8, has been determined.

Art. 10

1. If financial instruments are measured at current value, the market value is eligible for those. If a reliable market value for the financial instruments cannot immediately be identified, the market value shall be approximated by:
   a. deriving it from the market value of its components or of a similar instrument if a reliable market can be identified for the components of that or for a similar instrument; or
   b. using generally accepted valuation models and valuation techniques.

2. Liabilities shall only be measured at current value if they:
   a. are financial instruments which form part of the trading portfolio;
   b. are derivative financial instruments; or
   c. are insurance liabilities or pension liabilities.
3. Measurement at current value is not permitted for:
   a. non-derivative financial instruments held to maturity, except for investments of insurance companies as referred to in Article 442 of Book 2 NCC;
   b. loans granted or receivables to be collected by the entity which form no part of the trading portfolio or of the investments of insurance companies as referred to in Article 442 of Book 2 NCC;
   c. interests in subsidiaries, in participating interests as referred to in Article 389 paragraph 1 of Book 2 NCC and in entities in which participation takes place according to a mutual cooperation arrangement, equity instruments issued by the entity, agreements which involve a possible contribution in the context of a cooperation between companies, and other financial instruments which have such specific characteristics that, in accordance with generally accepted practice, reporting over these instruments does not have to be at current value; and
   d. financial instruments of which the current value cannot be reliably determined on the application of the first paragraph; they shall be measured at the acquisition price.
4. A commodities contract, which gives either party the right to settlement in cash or in any other financial instrument, shall be considered to be a derivative financial instrument, unless:
   a. the commodities contract was entered into and is durable for the expected purchase needs, selling needs or usage needs of the entity;
   b. the commodities contract was designated at the inception for the purpose referred to in part *a*; and
   c. it may be assumed that the commodities contract will be settled by delivery of the commodity.
5. Assets or liabilities of which the risks have been or were hedged by transactions as referred to in Article 384 paragraph 8 of Book 2 NCC, may be measured with the inclusion of the changes in value as referred to in that paragraph.

Art. 11

1. If assets, other than financial instruments, which may generate income as investment, are measured at current value, the market value is eligible for those. The present value of the estimated future cash flows can be used as an approximation of the market value.
2. If the value of the assets referred to in the first paragraph is approximated, it shall be disclosed in the notes:
   a. which approximation method has been applied; and
   b. if the value was estimated based on the present value of the expected future cash flows, the assumptions on which the expectations were based and the interest rate applied.

Art. 12

If a participating interest is measured at the net equity value, the Articles 6 to 11 shall apply to the measurement of the assets of the entity or company in which is participated.

Art. 13

The Asset Valuation Decree is withdrawn.

Art. 14

The Articles of this Decree apply to financial statements which are prepared for financial years that started on or after 1 January 2005.

Art. 15

If the legislative proposal submitted by royal message of 7 September 2004 to amend Book 2 NCC for the implementation of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards for financial statements (*OJEU* L243), of Directive 2001/65/EC of the European Parliament and of the Council of 27 September 2001 amending Directives 78/660/EEC, 83/349/EEC and 86/635/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions (*OJEU* L283), and of Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings (*OJEU* L178) (Implementation of IAS regulation, IAS

39 regulation and modernisation regulation Act), Parliamentary Papers II 2003/04, 29 737, after that has become law, comes into force, then this Decree will come into force at the same time.

Art. 16
This Decree may be cited as: Decree on current value.

Annex 4 Decree on annual accounts format

Art. 1

1. The balance sheet of a public or private limited liability entity shall be prepared in accordance with model A or model B, the profit and loss account in accordance with model E or model F. These models are enclosed as Appendix to this Decree.
2. If Article 396 of Book 2 NCC applies, the entity may also choose model C or model D for the balance sheet and model I or model J for the profit and loss account. These models are enclosed to this Decree.
3. This Decree does not apply to a legal entity as referred to in Article 395a of Book 2 NCC.

Art. 2
(lapsed)

Art. 3
The items are filled in separately and clearly in one or more columns. In addition, the amounts for the previous reporting year shall be provided as far as possible. Above the columns, the balance sheet shows the balance sheet date and the profit and loss account shows the financial year to which they relate.

Art. 4

1. The designation of the chosen model may be omitted; the font type is free.
2. The letters and figures before the items may be omitted or replaced.
3. Items without amount shall be omitted, unless an amount for the previous year shall be reported. The presence of an item in a model allows for no amount to be filled in, if the law permits that.

Art. 5

1. No deviation may be made from the names Fixed assets, Current assets, Current debts, Non-current debts, Provisions and Equity.
2. Other names may only be replaced by names that, in the case in question, indicate the content of the item or total in a manner that is at least as clear.
3. The outcome of subtotals may be inserted and named.
4. Subtotals and final totals in the models which are not mentioned in the Articles 364 up to and including 377 of Book 2 NCC or, insofar as it concerns banks, or insofar as it concerns insurance companies, in the Articles 429 up to and including 440 of that Book, in the Financial Statements of Banks Decree may not be named. Consecutive subtotals which do not differ from each other due to the lack of items in between, may be combined.

Art. 6

1. The order of the items shall be that of the chosen model. The item 'share in profit/loss of companies in which is participated' may also precede all financial income and expenses.
2. Private equity firms may change the order of the items in accordance with the use in their industry.
3. Private equity firm is understood in this Article to mean a legal entity or company whose activities are exclusively or almost exclusively limited to the participation in other legal entities or companies without any involvement with the business operations of that, except through exercising shareholders rights.

Art. 7

1. A specification may be added to the items of the models; they may be replaced by a specification.
2. Items may be inserted insofar as their contents is not covered by an item mentioned in the chosen model which is not designated as 'other'.
3. The other taxes referred to in the Articles 377 paragraph 1 under *c* and 437 paragraph 5 under *c* of Book 2 NCC and paragraph 9 paragraph 1 under *c* of the Financial Statements of Banks Decree must be presented in the profit and loss account immediately before the item profit or loss after taxes or immediately before the item referred to in Article 10 paragraph 3.
4. If income must be accounted for from participating interests which are not measured in accordance with Article 389 of Book 2 NCC, this must be presented separately as the first item of the financial income under the name: distributions from participating interests not measured at net equity value, etc. Changes in value in these participating interests are either presented separately immediately after the changes in value of receivables

which belong to the fixed assets and of securities, or aggregated with that item; in the latter case, the name may be adjusted if necessary.

Art. 8

1. Each uninterrupted sequence of items numbered with Arabic numerals in a model can be presented wholly or partially in the notes instead of in the balance sheet, with repetition of the sum.
2. Each uninterrupted sequence of items not expressed with capital letters in the profit and loss account can be presented wholly or partially in the notes instead of in the profit and loss account, with repetition of the sum.
3. Insofar as this Article is applied, the sequences are presented in the notes in the order of the chosen model.

Art. 9

When an amount could be presented under more than one item, it must be disclosed in the notes under which other item or items the amount could have been presented, how large the amount is and to what it relates, if the insight referred to in Article 362 paragraph 1 of Book 2 NCC is served by that.

Art. 10

1. All names in consolidated financial statements may be adjusted in order to indicate the group nature.
2. In a consolidated balance sheet, the share of third parties in group companies shall be presented separately as part of the group equity. For the rest, subdivision of the equity is not required in consolidated financial statements.
3. A consolidated profit and loss account shall present separately the share of third parties in the consolidated profit or loss after taxes; if it is presented separately, it shall be presented after the profit or loss from ordinary activities after taxes and after the extraordinary profit or loss after taxes.

Art. 11

At the top of the balance sheet it shall be indicated whether the appropriation of the profit or loss has been included. If the appropriation of the profit or loss has not been included, then it must be presented separately as the last item of the equity.

Art. 12

1. In the models A, B, C and D, the item ‘prepayments and accrued income’ may also be presented independently after the cash and cash equivalents.
2. In the models B and D, the item ‘accruals and deferred income’ may also be presented independently after the debts and, in the models A and C after the provisions.
3. In the notes and in the models B and R, the specifications of the current and non-current debts may be given jointly, provided that the subdivision is shown again in the notes.

Art. 13

(lapsed)

Art. 14

1. In model F, the items Sum of the costs and Net turnover profit or loss may be omitted.
2. In the models I and J, the column layout may be deviated from.

Art. 15

Insofar as the legally required signatures are placed on the original copy of the financial statements, other copies may simply report the names of the signatories. If a signature is missing on the original copy, the reason for that must be reported in the other copies.

Art. 16

1. For banks as referred to in Article 415 of Book 2 NCC, the Articles 3, 4, 5 paragraphs 3 and 4, 6 paragraph 1, first sentence, 7 paragraphs 2 and 3, 8 paragraphs 1 and 3, 9, 10, 11 and 15 shall apply.
2. The balance sheet of a bank must be prepared in accordance with model K, the profit and loss account in accordance with the models L or M. These models are enclosed as Appendix to this Decree.
3. The items of model K provided with capital letters and the items in the models L and M printed with capital letters shall be reported, even if these are of negligible significance in the entire financial statements for the legally required insight.

4. Mortgage banks shall present two items in the balance sheet under the assets instead of the item ‘receivables from clients’, which shall respectively be called: receivables from clients from mortgage loans and other receivables from clients. Instead of the item ‘Debt securities’, these banks shall present two items under the liabilities, which shall respectively be called: letters of pledge and other debt securities. They are permitted to merge the item ‘Cash’ with the item ‘Receivables from banks’, unless the size of the cash is significant with regard to the entire assets.
5. The names used in the models K, L and M may only be replaced by names which, in the case in question, indicate at least as clearly the contents of the item or total.
6. A specification may be added to the items in these models.
7. If income must be accounted for from participating interests which are not measured in accordance with Article 389 of Book 2 NCC, this shall be presented separately and immediately after the income from participating interests respectively group companies under the name: income from participating interests not measured at net equity value.
8. The share in profit/loss of companies in which is participated shall be presented under the income from participating interests respectively group companies and shall be disclosed in the notes.
9. Each uninterrupted sequence of numbered items with Arabic numerals in the models L and M can be presented wholly or partially in the notes instead of in the profit and loss account, with repetition of the sum. The sequences shall be presented in the notes in the order of the chosen model.

Art. 16a
1. For insurance companies as referred to in Article 427 of Book 2 NCC, the Articles 3, 4, 5 paragraphs 3 and 4, 6 paragraph 1, first sentence, 7 paragraphs 2 and 3, 8 paragraphs 1 and 3, 9, 10, 11 and 15 shall apply.
2. The balance sheet of an insurance company must be prepared in accordance with model N, the profit and loss account in accordance with model O. Model P may be used for the non-life insurance technical account, if the investments can be directly allocated to the non-life insurance business. These models are enclosed as appendix to this Decree.
3. The names used in the models N, O and P may only be replaced by names which, in the case in question, indicate at least as clearly the contents of the item or total.
4. A specification may be added to the items of the models.
5. If gross premiums in the life insurance technical account include single premiums from profit sharing, the amount thereof will be disclosed separately in the notes.
6. The share in profit/loss of companies in which is participated shall be presented under the income from participating interests and shall be disclosed in the notes.
7. If income must be accounted for from participating interests which are not measured in accordance with Article 389 of Book 2 NCC, this will be presented separately from and immediately following the income from participating interests under the name: income from participating interests not measured at net equity value.
8. In the consolidated financial statements of an insurance company, all income from investments may be included in the non-technical account. In model O, the items income from investments and investment expenses, as well as the items unrealised profit on investments and unrealised loss on investments, will then lapse in the technical accounts. The item income from investments is replaced by the item allocated income from investments.
9. Each uninterrupted sequence of items numbered with Arabic numerals in the models O and P can be presented wholly or partially in the notes instead of in the profit and loss account, with repetition of the sum. The sequences shall be presented in the notes in the order of the chosen model.

Art. 16b
1. The Articles 2 to 4, 5, paragraphs 3 and 4, 6 paragraph 1, first sentence, 7 paragraphs 1 to 3, 8 to 11, 12 paragraph 3, and 15 shall apply to investment companies or companies for collective investment in securities as referred to in article 1:1 of the Financial Supervision Act.
2. The balance sheet of an investment company or company for collective investment in securities must be focused (*ed.*: read: prepared) in accordance with model Q or R, the profit and loss account in accordance with model S. These models are enclosed as Appendix to this Decree.
3. If an investment company or company for collective investment in securities applies the second sentence of Article 401, paragraph 2 NCC, it shall present an item outside the count of the profit and loss account under the name ‘changes in the reserves as a result of translation differences’.
4. An investment company or company for collective investment in securities, which invests in real estate, may, for the purpose of providing insight into the operating profit or loss in relation to the real estate, present the depreciations on investments in real estate as well as the other expenses and costs relating to these investments, immediately under the income from investments in land and buildings in the profit and loss account.

5. The names used in the models Q, R and S may only be replaced by names which, in the case in question, indicate at least as clearly the contents of the item or total.
6. If income must be presented from participating interests which are not measured in accordance with Article 389 of Book 2 NCC, this will be presented separately and immediately following the income from participating interests under the name: income from participating interests not measured at net equity value.

Art. 17
This Decree can be cited as 'Decree on annual accounts format'.

Art. 18
1. This Decree shall enter into force starting on the day on which Title 8 of Book 2 NCC acquires the force of law.
2. It shall apply to financial statements to which Title 8 of Book 2 NCC applies.

Note:
1. Article 18: Title 8 of Book 2 NCC has been replaced by Title 9.
2. The models A to J are also included in this Annex 4. The models K to S are not included because these concern special industries which are not covered in this book.

Model A Balance sheet of a large or medium-sized entity

Balance sheet as at				
A.	**Fixed assets**			
I.	*Intangible fixed assets*			
	1.	incorporation and share issue expenses	...	
	2.	development costs	...	
	3.	concessions, licences and intellectual property rights	...	
	4.	goodwill	...	
	5.	prepayments on intangible fixed assets	...	
				...
II.	*Tangible fixed assets*			
	1.	land and buildings	...	
	2.	plant and machinery	...	
	3.	other operating fixed assets	...	
	4.	tangible fixed assets under construction and prepayments on tangible fixed assets	...	
	5.	tangible fixed assets not used in operations	...	
				...
III.	*Financial fixed assets*			
	1.	participations in group entities	...	
	2.	receivables from group entities	...	
	3.	other participating interests	...	
	4.	receivables from shareholders and participating interests	...	
	5.	other securities	...	
	6.	other receivables	...	
				...
IV.	*Total fixed assets*			...
B.	**Current assets**			
I.	*Inventories*			
	1.	raw materials and consumables	...	
	2.	work in progress	...	
	3.	finished goods and goods for resale	...	
	4.	prepayments on inventories	...	
				...
II.	*Receivables*			
	1.	trade debtors	...	
	2.	group entities	...	
	3.	shareholders and participating interests	...	
	4.	other receivables	...	
	5.	called up share capital not yet paid in	...	
	6.	prepayments and accrued income	...	
				...
III.	*Securities*			...
IV.	*Cash*			...
V.	*Total current assets*			...
C.	**Short-term liabilities**			
	1.	convertible loans	...	
	2.	other debenture loans and private loans	...	
	3.	banks	...	
	4.	payments received on account	...	
	5.	trade creditors	...	
	6.	bills of exchange and cheques payable	...	
	7.	amounts due to group entities	...	
	8.	amounts due to shareholders and participating interests	...	
	9.	taxes and social security contributions	...	
	10.	pension liabilities	...	
	11.	other liabilities	...	
	12.	accrued liabilities and deferred income	...	

				...
D.	**Balance of current assets less short-term liabilities**			...
E.	**Total assets less short-term liabilities**			...
F.	**Long-term liabilities**			
	1.	convertible loans	...	
	2.	other debenture loans and private loans	...	
	3.	banks	...	
	4.	payments received on account	...	
	5.	trade creditors	...	
	6.	bills of exchange and cheques payable	...	
	7.	amounts due to group entities	...	
	8.	amounts due to shareholders and participating interests	...	
	9.	taxes and social security contributions	...	
	10.	pension liabilities	...	
	11.	other liabilities	...	
	12.	accrued liabilities and deferred income	...	
				...
G.	**Provisions**			
	1.	pensions	...	
	2.	taxation	...	
	3.	other provisions	...	
				...
H.	**Shareholders' equity**			
I.	*Share capital paid up and called up*			...
II.	*Share premium (paid-in surplus)*			...
III.	*Revaluation reserves*			...
IV.	*Legal and statutory reserves*			
	1.	legal reserves	...	
	2.	statutory reserves	...	
				...
V.	*Other reserves*			...
VI.	*Unappropriated profits*			...
				...

Model B Balance sheet of a large or medium-sized entity

Balance sheet as at

	Assets		
A.	**Fixed assets**		
I.	*Intangible fixed assets*		
1.	incorporation and share issue expenses	...	
2.	development costs	...	
3.	concessions, licences and intellectual property rights	...	
4.	goodwill	...	
5.	prepayments on intangible fixed assets	...	
			...
II.	*Tangible fixed assets*		
1.	land and buildings	...	
2.	plant and machinery	...	
3.	other operating fixed assets	...	
4.	tangible fixed assets under construction and prepayments on tangible fixed assets	...	
5.	tangible fixed assets not used in operations	...	
			...
III.	*Financial fixed assets*		
1.	participations in group entities	...	
2.	receivables from group entities	...	
3.	other participating interests	...	
4.	receivables from shareholders and participating interests	...	
5.	other securities	...	
6.	other receivables	...	
			...
B.	**Current assets**		
I.	*Inventories*		
1.	raw materials and consumables	...	
2.	work in progress	...	
3.	finished goods and goods for resale	...	
4.	prepayments on inventories	...	
			...

	Shareholders' equity, provisions and liabilities		
A.	**Shareholders' equity**		
I.	*Share capital paid up and called up*		...
II.	*Share premium (paid-in surplus)*		...
III.	*Revaluation reserves*		...
IV.	*Legal and statutory reserves*		
1.	legal reserves	...	
2.	statutory reserves	...	
			...
V.	*Other reserves*		...
VI.	*Unappropriated profits*		...
			...
B.	**Provisions**		
1.	pensions	...	
2.	taxation	...	
3.	other provisions	...	
			...
C.	**Long-term liabilities**		
1.	convertible loans	...	
2.	other debenture loans and private loans	...	
3.	banks	...	
4.	payments received on account	...	
5.	trade creditors	...	
6.	bills of exchange and cheques payable	...	
7.	amounts due to group entities	...	
8.	amounts due to shareholders and participating interests	...	
9.	taxes and social security contributions	...	
10.	pension liabilities	...	
11.	other liabilities	...	
12.	accrued liabilities and deferred income	...	
			...

II.	*Receivables*		
1.	trade debtors	...	
2.	group entities	...	
3.	shareholders and participating interests	...	
4.	other receivables	...	
5.	called up share capital not yet paid in	...	
6.	prepayments and accrued income	...	
			...
III.	*Securities*		...
IV.	*Cash*		...
			...
	Total		...

D.	**Short-term liabilities**		
1.	convertible loans	...	
2.	other debenture loans and private loans	...	
3.	banks	...	
4.	payments received on account	...	
5.	trade creditors	...	
6.	bills of exchange and cheques payable	...	
7.	amounts due to group entities	...	
8.	amounts due to shareholders and participating interests	...	
9.	taxes and social security contributions	...	
10.	pension liabilities	...	
11.	other liabilities	...	
12.	accrued liabilities and deferred income	...	
			...
	Total		...

Model C Balance sheet of a small entity

Balance sheet as at			
A.	**Fixed assets**		
I.	Intangible fixed assets	...	
II.	Tangible fixed assets	...	
III.	Financial fixed assets	...	
IV.	Total fixed assets		...
B.	**Current assets**		
I.	Inventories	...	
II.	Receivables, including prepayments	...	
III.	Securities	...	
IV.	Cash	...	
V.	Total current assets		...
C.	**Short-term liabilities and accrued liabilities**		...
D.	**Balance of current assets less short-term liabilities**		...
E.	**Balance of assets less short-term liabilities**		...
F.	**Long-term liabilities**		...
G.	**Provisions**		...
H.	**Shareholders' equity**		
I.	Share capital paid up and called up	...	
II.	Share premium (paid-in surplus)	...	
III.	Revaluation reserves	...	
IV.	Legal and statutory reserves	...	
V.	Other reserves	...	
VI.	Unappropriated profits	...	
			...
			...

Model D Balance sheet of a small entity

Balance sheet as at

	Assets		
A.	**Fixed assets**		
I.	Intangible fixed assets	…	
II.	Tangible fixed assets	…	
III.	Financial fixed assets	…	
			…
B.	**Current assets**		
I.	Inventories	…	
II.	Receivables, including prepayments	…	
III.	Securities	…	
IV.	Cash	…	
			…
	Total		…

	Shareholders' equity, provisions and liabilities		
A.	**Shareholders' equity**		
I.	Share capital paid up and called up	…	
II.	Share premium (paid-in surplus)	…	
III.	Revaluation reserves	…	
IV.	Legal and statutory reserves	…	
V.	Other reserves	…	
VI.	Unappropriated profits	…	
			…
B.	**Provisions**		…
C.	**Long-term liabilities**		…
D.	**Short-term liabilities and accrued liabilities**		…
	Total		…

Model E Profit and loss account of a large or medium-sized entity (expenses presented by nature)

Profit and loss account for the year		
Net turnover	...	
change in inventories of finished goods and in work in progress	...	
capitalised production (on behalf of own business)	...	
other operating income	...	
Total operating income		...
raw materials and consumables	...	
other external charges	...	
wages and salaries	...	
social security costs	...	
amortisation/depreciation of intangible and tangible fixed assets	...	
other changes in value of intangible and tangible fixed assets	...	
impairment of current assets	...	
other operating expenses	...	
Total operating expenses		...
		...
income from receivables included in fixed assets and from investments		...
other interest income and similar income		...
changes in value of receivables included in fixed assets and of investments		...
interest expenses and similar charges		...
Profit/loss before taxation		...
taxation		...
share in profit or loss from participating interests*		...
Profit/loss after taxation		...

* Only the profit or loss from participating interests that are valued using the net asset value method (article 389-2 NCC) is included in this item. Income from participating interests valued differently must be shown separately as the first item of the financial income section, as 'income from participating interests, not valued using the net asset value method' (article 7(4) BMJ).

Model F Profit and loss account of a large or medium-sized entity (expenses presented by function)

Profit and loss account for the year		
Net turnover		...
cost of sales		...
Gross margin		...
selling expenses	...	
administrative expenses	...	
Total selling and administrative expenses		...
Net margin		...
other operating income		...
income from receivables included in fixed assets and from investments		...
other interest income and similar income		...
changes in value of receivables included in fixed assets and of investments		...
interest expenses and similar charges		...
Profit/loss before taxation		...
taxation		...
share in profit or loss from participating interests*		...
Profit/loss after taxation		...

* Only the profit or loss from participating interests that are valued using the net asset value method (article 389-2 NCC) is included in this item. Income from participating interests valued differently must be shown separately as the first item of the financial income section, as 'income from participating interests, not valued using the net asset value method' (article 7(4) BMJ).

Model I Profit and loss account of a small entity (expenses presented by nature)

Profit and loss account for the year		
Gross margin		...
wages and salaries	...	
social security costs	...	
amortisation/depreciation of intangible and tangible fixed assets	...	
other changes in value of intangible and tangible fixed assets	...	
impairment of current assets	...	
other operating expenses	...	
Total operating expenses		...
		...
income from receivables included in fixed assets and from investments	...	
other interest income and similar income	...	
changes in value of receivables included in fixed assets and of investments	...	
interest expenses and similar charges	...	
		...
Profit/loss before taxation		...
taxation		...
share in profit or loss from participating interests*		...
Profit/loss after taxation		...

* Only the profit or loss from participating interests that are valued using the net asset value method (article 389-2 NCC) is included in this item. Income from participating interests valued differently must be shown separately as the first item of the financial income section, as 'income from participating interests, not valued using the net asset value method' (article 7(4) BMJ).

Model J Profit and loss account of a small entity (expenses presented by function)

Profit and loss account for the year		
Gross margin		...
selling expenses	...	
administrative expenses	...	
Total selling and administrative expenses		...
		...
income from receivables included in fixed assets and from investments	...	
other interest income and similar income	...	
changes in value of receivables included in fixed assets and of investments	...	
interest expenses and similar charges	...	
		...
Profit/loss before taxation		...
taxation		...
share in profit or loss from participating interests*		...
Profit/loss after taxation		...

* Only the profit or loss from participating interests that are valued using the net asset value method (article 389-2 NCC) is included in this item. Income from participating interests valued differently must be shown separately as the first item of the financial income section, as 'income from participating interests, not valued using the net asset value method' (article 7(4) BMJ).

Other models

The BMJ furthermore includes balance sheet models K, N, Q and R and profit and loss account models L, M, O, P and S. These models pertain to specific industries such as financial institutions, etc., which are out of scope for this publication. Profit and loss account model G and H have expired per 1 November 2015.

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