

Changes to Dutch Accounting Standards for large and medium-sized legal entities

Changes to regulations for financial years as from 2014

In the annual edition 2013 of the Dutch Accounting Standards (DASs) for large and medium-sized legal entities, several standards have become final. These final standards are effective for financial years starting on or after 1 January 2014. Earlier application is recommended. New draft standards have been included as well. Draft standards do not yet formally apply. Anticipating the final standards, the Dutch Accounting Standards Board (DASB) does expect draft standards to already provide the accounting practice with a certain extent of support and guidance (DAS 100.206).

This publication outlines the changes in the DASs for large and medium-sized entities. Please note that industry specific changes (such as for banks, pension funds, educational institutions, health care institutions) are not addressed

Final standards

Presentation of gross versus net revenue (including taxes)

Net revenue only consists of amounts received for the company's own account; it does not comprise amounts received for third parties. For commission businesses, for instance, the commission income rather than the transaction value of concluded contracts will be reported as revenue. In situations where agents render services on a commission basis, too, only the provision received will be recognised as revenue. Nothing new so far.

What is new is that some paragraphs include concrete indicators for determining whether amounts are received for an entity's own account or for that of third parties. These indicators have been derived from IFRS and relate to the economic benefits and risks of a legal entity, e.g., inventory risk and credit risk. Another important indicator is who has primary responsibility for the supply of the goods or services. Not a single feature in itself is decisive.

These new paragraphs also clarify that this equally applies to taxation. This has, in fact, also been laid down by law: Article 377(6), Book 2 NCC stipulates that sales taxes, such as VAT, do not belong to the net revenue. This may be quite different for other taxes, though.

Example: Excise tax presentation in the income statement

Company A imports wines from all reputed wine regions around the world and sells them in the Netherlands. The company is liable for Dutch excise duties in respect of the imported wines. The importer holds an excise warehouse ["Accijns Goederen Plaats"]. The excise duties are chargeable as the wines are removed from the excise warehouse. Dutch excise duty is a tax chargeable on imported or produced quantities of a product, in respect of which the importer or manufacturer runs significant risks:

- excise duties are also chargeable on excise goods that are missing from the excise warehouse and on goods that have gone lost without this being demonstrable;
- the importer or manufacturer is completely free to charge on the excise duties in their selling prices. Goods may very well be sold below their excise value. Nor does an increase or reduction of the excise duties have to lead to a change of the selling price. Obviously, this immediately affects the results realised by the importer or manufacturer; and
- there is no excise refund scheme if the eventual buyer does not pay the invoice.

So the excise duties included in the price charged by the importer or manufacturer to the consumer will belong to the net revenue of that importer or manufacturer. This may be different for foreign excise duties, depending on the applicable excise regulations.

Disclosure of audit fees

Article 382a(2), Book 2 NCC obliges large legal entities to disclose the audit fees recognised in the income statement during the financial year. The basic assumption is that the disclosure should serve to assess the independence of the external auditor who audited the financial statements.

The law requires audit fees to be disclosed on a consolidated basis. Apart from the fee for work performed by the external auditor and the audit firm he/she belongs to, the DASB strongly recommends to also disclose the fees related to the national or international network the external auditor is part of. If applicable, the DASB also advises to disclose that a material part of the subsidiaries included in the consolidation is audited by another external auditor. And to also disclose the fees of this external auditor. Finally, the DASB recommends including this information in the notes to the consolidated financial statements.

The new Standard also takes account of legislative changes that were introduced on 1 October 2012. These imply that :

- the audit fees must also be disclosed by legal entities that prepare financial statements under IFRS-EU; and
- the exemption from disclosure of audit fees by group companies only applies if the audit fees are disclosed in the consolidated financial statements of a "European" parent company.

Directors' report

As it states in the introduction to the annual edition 2013, the DASB is currently discussing DAS 400 "Annual report". In anticipation of this, the annual edition 2013 once again clarifies this in DAS 400.110a, specifying that disclosing information about the most important risks and uncertainties will enable the reader of an annual report to obtain a clear understanding of any events or developments with major consequences for the results, the financial position and, if applicable, the continuity of specific or all activities of the legal entity.

Draft standards

Financial instruments

The introduction to the annual edition 2013 includes an announcement by the DASB about its discussion on changes to DAS 290 "Financial instruments". Meanwhile, DASB-Statement 2013-12 was published in September 2013, a Statement relevant to legal entities using hedge instruments to cover specific financial risks, such as interest rate risks and currency exchange risks. The Statement is equally relevant to legal entities with embedded derivatives. One example of an embedded derivative is a conversion option recorded in a loan. The Statement contains the following proposals:

- more detailed provisions about how ineffectiveness should be determined and recognised if cost price hedge accounting is applied;
- additional requirements for disclosing the ineffectiveness of hedge instruments and the cash flow risks arising from hedge relationships;
- the possibility to opt for an accounting policy on derivatives for each separate type of hedge relationship; and
- the introduction of the requirement to always separate embedded derivatives that meet certain conditions from the host contract from now on. The currently available options to avoid separation from the host contract will be removed consequently.

If these proposals become final standards, the adjustments will become effective for financial years starting on or after 1 January 2014, with a strong recommendation for earlier application. The DASB even considers implementing the amendments retrospectively for financial years starting on or after 1 January 2013. This decision will be taken when the proposals are made final and will include any comments submitted.

Principles in the event of discontinuity

The going concern assumption will be cancelled if discontinuity is unavoidable. The financial statements will then have to be prepared on the basis of liquidation of all activities of the legal entity (DAS 170.201). As to how liquidation principles should be interpreted had not been specifically explained up to now. Draft DAS 170.204 through 207 now include proposals to that end. Effectively, they imply that the shareholders' equity recorded in a balance sheet based on discontinuity would arrive at the expected balance remaining after liquidation, because the liquidation principles proposed state the following:

- all assets should be measured at fair value less costs of disposal, also recognising value increases and internally developed immaterial fixed assets in the balance sheet. This may even lead to capitalisation of internally generated goodwill, in situations where a company may be sold as part of the liquidation;
- all liabilities should be measured at their contractual settlement amount (or at their best estimate). For financial liabilities this is usually the nominal value. Provisions and taxes (deferred or otherwise) are recognised and measured in accordance with the 'regular' accounting policies of DAS 252 and DAS 272. An explicit statement has been included for financial liabilities. These may not be released until a transaction causes extinguishment, e.g., due to payment or cancellation; and
- prepayments and accruals should be recorded for expected costs and revenues up to the expected date of settlement. This includes the expected liquidation costs and expected (future) operating results.

The proposed liquidation principles will not apply to legal entities set up for a limited period, or which the board of directors - or another body authorised to do so - decides to continue for a limited period after their incorporation. This is conditional to the discontinuation of the business operations being executed according to a scenario determined upon incorporation (or after the said decision), according to which the legal entity is expected to satisfy all of its obligations. These legal entities will prepare the financial statements according to the 'regular' continuity principles.

Revaluation reserve in the event of investment property measured at fair value

There is uncertainty about how to determine the revaluation reserve amount in the event of investment property measured at fair value. This concerns the question whether depreciation on the initial cost or manufacturing price should be taken into account. Draft DAS 213.504 proposes a recommendation about determining the revaluation reserve based on the difference between the fair value and the carrying amount, which is based on the cost or manufacturing price, including the accumulated depreciation and impairment losses that would have been determined had this investment property been measured at cost. Alternatively, it is deemed acceptable to determine the revaluation reserve based on the initial cost or manufacturing price without taking into account the accumulated depreciation and impairment losses. This is due to the legal provisions being ambiguous and because this carrying amount (whether virtual or not), including the accumulated depreciation and impairment losses, may be difficult to determine. The method used should be disclosed in the notes. Irrespective of the option chosen to determine the revaluation reserve amount, investment property measured at fair value in accordance with DAS 213.503 is not depreciated.

Example: Determining the revaluation reserve amount in the event of investment property measured at fair value

A company acquires a property for 1,200 at the start of year 1. After the initial recognition at cost, the company measures the property at fair value. The property's expected useful life is 40 years. The fair value is 1,380 at the end of year 12. The revaluation reserve amount may be determined according to two methods (draft DAS 213.504):

1. including accumulated depreciation and impairment losses (recommended): according to the recommended method the revaluation reserve is 540 at the end of year 12 (= 1,380 – 840; with which $840 = 1,200 - 1,200 \times 12/40$).
2. excluding accumulated depreciation and impairment losses (alternative): according to the alternative method the revaluation reserve is only 180 at the end of year 12 (= 1,380 – 1,200).

If, as a result of draft DAS 213.504, the revaluation reserve is determined according to another method than applied in the prior reporting period, this constitutes a change in accounting policy. Nevertheless, draft DAS 213.902 proposes – in contrast to DASB 140 "Changes in accounting policies" – to allow the prospective recognition of any changes due to the application of draft DAS 213.504.

Business combinations and acquisitions between companies under common control

Draft DAS 216.503 proposes that business combinations and acquisitions between companies under common control should solely be recognised in the consolidated financial statements according to the purchase accounting method if this is in line with the economic substance of the transaction. The DASB has not explained when this occurs.

In our opinion it should be assessed to what extent the economic substance changes due to a business combination or acquisition under common control. If there is no or only a minor change in the economic situation, we argue it will be more difficult to defend a recognition of transactions according to the purchase accounting method.

If recognition does not take place according to the purchase accounting method, a choice should be made between the pooling of interests method or the carryover accounting method. Both methods consolidate the carrying amounts of the assets and the obligations. As a result, no goodwill arises. When applying the pooling of interests method the business combination is recognised as if it had already existed at the start of the book year's comparative period. When applying the carryover accounting method the combination is recognised on the acquisition date and the comparative figures need not be adjusted.

These three methods may also be applied for the company-only financial statements when recognising participating interests resulting from business combinations and acquisitions under common control, in which the legal entity effectively exercises control (draft DAS 214.622).

Whatever method is applied, it should clearly be disclosed which transactions have taken place and how they have been recognised, as well as the reason for opting for a particular accounting treatment.

Reverse acquisitions

A reverse acquisition concerns the situation where the legally acquiring party (A) issues shares to the shareholders of the (legally) acquired party (B) to such extent that the latter party obtains the majority of the voting powers. A reverse acquisition is recognised in the consolidated financial statements in accordance with the economic form (DAS 216.109). Hence, the legal acquirer (A) is regarded as the acquiree for accounting purposes, while the legal acquiree (B) is regarded as the acquirer for accounting purposes. The goodwill of A (the acquiree) will then be recognised in the consolidated balance sheet instead of the goodwill of B (the acquirer).

The question is how to recognise a reverse acquisition in the company-only financial statements of the legal acquirer (A). Draft DASs 214.342 and 216.109 clarify that two accounting treatments are available: according to the economic substance or according to the legal form. When applying the accounting treatment according to the economic substance, the acquirer is the same as in the consolidated financial statements (B). When applying this accounting treatment there is no difference between the consolidated and the company-only shareholders' equity. Just like in the consolidated balance sheet, in A's company-only balance sheet A's assets and liabilities will be revalued to their fair value, while A's goodwill will be recorded. The participating interest in B will be recorded at the net asset value as determined on the basis of the carrying amounts of B's assets and liabilities. When applying the accounting treatment according to the legal form, the party issuing the shares will be regarded as the acquiring party (A). Applying this accounting treatment does create a difference between the consolidated and company-only shareholders' equity, because B's goodwill will now be recorded in A's company-only balance sheet, while A's goodwill will be recorded in the consolidated balance sheet. The participating interest in B will be recorded at the net asset value as determined on the basis of the fair value of B's assets and liabilities.

Assessing control

Draft DAS 214.303 and draft DAS 217.203 propose a clarification of how to assess whether potential voting powers (which usually occur in the form of options) result in significant influence or control. This is relevant to how participating interests should be measured and to determine whether it concerns an interest that should be consolidated. The assessment will from now on also take account of the intention of management and the financial possibility to exercise an instrument. According to the current standards this is not allowed.

Draft DAS 217.202a furthermore proposes to include other rights, in addition to voting powers, when assessing control. This may include rights resulting from a shareholders' agreement or a loan agreement. The ensuing rights may, however, be protective rights. Protective rights do not give a party power over the investee, as they are solely meant to protect the interest of the holder of the rights. One can think of the right of a minority interest shareholder to approve decisions related to, e.g., major capital expenditures or directors' remunerations.

Management and Supervision (Public and Private Companies) Act; notification of remuneration directors in the event of a one-tier board

As from 1 January 2013, the articles of association may include a notification that the directors' duties in an N.V. or a B.V. have been divided over one or more executive and one or more non-executive directors (articles 2:129a and 239a NCC); the so-called one-tier board. Article 2:383 NCC requires the disclosure of the aggregate amount of remunerations for the directors and supervisory directors in the financial statements.

Also based on the legislative history, the DASB takes the position that the application of this article should provide insight into the total management costs and the total costs for supervision of the management. Hence, draft DAS 271.605 includes a proposal for an authoritative statement according to which, in the event of a one-tier board, the disclosure of the aggregate amount of the directors' remuneration is split into the remuneration for the executive and for the non-executive directors, unless this disclosure can be traced to a single natural person (either an executive or non-executive director). This draft DAS is intended to be made final as soon as possible.

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