

# Accounting policy manual

## Chapter 0: Introduction to the Accounting Policy Manual

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Approved by:

SVP Consolidation and  
Internal Control

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## Chapter 0: Introduction to the Accounting Policy Manual

### 1. Introduction

#### 1.1. Purpose

The main purpose of NH Group's Accounting Policy Manual is to ensure uniformity and consistency of financial information in accordance with the International Financial Reporting Standards adopted by the European Union (hereinafter, "IFRS"). In this sense, the generally accepted accounting principles of NH Group will be those of IFRS together with interpretations or adaptations to the standard as detailed in each chapter (see 1.2). The aim will be to define NH Group's corporate accounting standards on an earlier basis. Specifically, the Manual will aim to:

- Define the principles, policies and corporate accounting standards which allows information to be comparable within NH Group and permit optimal management all the way from the information's origin.
- Improve the quality of accounting information produced by different Group companies as well as its Consolidated Group through the disclosure, agreement and implementation of single accounting principles.
- Facilitate the accounting integration of new companies brought into NH Group, be they new or via acquisition, by having an accounting policy manual as a reference.

#### 1.2. Scope

The manual covers the following headings:

| Chapters   |   |
|--|---|
| <a href="#">Intangible asset</a>                   | <a href="#">Foreign currency transactions</a>                 |
| <a href="#">Goodwill and business combinations</a> | <a href="#">Income tax</a>                                    |
| <a href="#">Property, plant and equipment</a>      | <a href="#">Share-based payments</a>                          |
| <a href="#">Impairment of non- current assets</a>  | <a href="#">Treasury shares</a>                               |
| <a href="#">Lease rentals</a>                      | <a href="#">Provisions, contingent assets and liabilities</a> |
| <a href="#">Subsidies</a>                          | <a href="#">Recognition of Income</a>                         |
| <a href="#">Financial instruments</a>              | <a href="#">Hyperinflation</a>                                |
| <a href="#">Cash flow statements</a>               |   |

#### 1.3. Contents

NH Group's accounting policies manual sets out the general accounting policies for the Group, taking into account all the rules applied by the Group as well as the scope and responsibilities, the general accounting principles and applicable international regulations.

## 2. Recipients

The principles and guidelines in NH Group's Accounting Policy Manual are to be applied to all companies included within NH Group's consolidation perimeter as well as joint ventures and associated entities.

For all NH Group's Business Units (hereinafter, "BU"), the financial managers will promote the adoption and compliance of the Accounting Policy Manual. Likewise, in those cases in which any of NH Group's companies have delegated the management through a Management Agreement, the Group should ensure that said managers apply the same guidelines as the Accounting Policy Manual.

## 3. Responsibility

### 3.1. Functions

The managers carrying out main functions in terms of NH Group's Accounting Policy Manual are as follows:

| Manager   | Functions  |
|---|--|
| BU Finance Managers                               | <ul style="list-style-type: none"> <li>- Preparation of the financial information of each BU applying that set out in the Accounting Policy Manual.</li> <li>- Supervising the correct application of NH Group's accounting policies by the accounting department of their BU.</li> <li>- Resolution of queries made to the accounting department of their BU.</li> <li>- To prepare, document and obtain necessary authorisations from the Accounting Policy Director in those cases set out in the Accounting Policy Manual</li> <li>- Suggest possible changes and additions according to needs which may arise in situations not considered at so far.</li> <li>-</li> </ul> |
| Manager of the Corporate Consolidation Department | <ul style="list-style-type: none"> <li>- Preparation of NH Group's consolidated financial information applying that set out in the Accounting Policy Manual.</li> <li>- Supervising the correct application of NH Group's accounting policies by the corporate consolidation department.</li> <li>- To prepare, document and obtain necessary authorisations from the Accounting Policy Director in those cases set out in the Accounting Policy Manual.</li> </ul>  |
| Accounting Policy Director                        | <ul style="list-style-type: none"> <li>- Preparing the Accounting Policy Manual</li> <li>- Periodic update of the Accounting Policy Manual</li> <li>- Reception, resolution, approval and filing of queries made by the financial managers of the BUs.</li> </ul>  |

|                     |  |
|---------------------|--|
|                     | <ul style="list-style-type: none"> <li>- Overall supervision of the Accounting Policy Manual's application in both the Bus and the corporate consolidation department.</li> </ul>  |
| Standards Committee | <ul style="list-style-type: none"> <li>- Annual meetings to monitor the drafting and implementation of the Accounting Policy Manual.</li> <li>- Analysis of the impact of new standards as well as approval for their inclusion into the Accounting Policy Manual.</li> <li>- Resolution of queries made by the Accounting Policy Director.</li> <li>- Approval to update the Accounting Policy Manual made by the Accounting Policy Director.</li> <li>- Authorisations of situations listed in section 3.4.</li> </ul> |

### 3.2. Maintenance and updating

The updating of this Accounting Policy Manual, due to policy changes or other reasons, must be carried out by the Group's Accounting Policy Director at least annually and approved by the Standards Committee. However, if the regulatory change is relevant or the updating of the policy due to a consultation, interpretation or other reason is required, the Accounting Policy Manual will be updated immediately.

### 3.3. New standards

In the case of new businesses within NH Group or non-standard transactions to date, the Accounting Policy Director should be informed who will call a meeting of the standards committee to define and communicate the new accounting policies for mandatory compliance in their application.

### 3.4. Authorisations

There are certain decisions which, in order to ensure a uniform application of the accounting policies, require authorisation from the Standards Committee. Matters for which this authorisation should be sought are the following:

- Criterion to adopt in NH Group where IFRS allows accounting alternatives.
- Early application of new IFRS or IFRIC.
- The change in accounting criteria where alternatives exist.
- The accounting treatment of any unusual operation which is significant for NH Group.

# Accounting policy manual

## Cash Flow Statement

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## Cash Flow Statement

### 1. Scope

This accounting policy will apply to all companies belonging to the Grupo NH consolidation perimeter.

With regard to companies over which significant influence is exercised in their management, the criteria set forth in these regulations will be applied to at least the financial statements which these companies must report for the purpose of preparing the Group's consolidated financial statements.

The cash flow statement has to be presented as an integral part of the financial statements of any company, for each period in which the presentation of these is mandatory.

The accounting criteria under this policy are derived from the application of the following international regulation:

| IAS / IFRS | Description         |
|------------|---------------------|
| IAS 7      | Cash Flow Statement |

### 2. Executive Summary

| Area                                | Concepts   | Ref. |
|-------------------------------------|--|------|
| <b>Definitions</b>                  |  |      |
| Cash                                | Cash is understood as cash in hand and demand deposits in banks.   | 3.1. |
| Cash equivalents                    | Cash equivalents are highly liquid short-term investments which are readily convertible into certain amounts of cash and are at little risk to changes in their value.   | 3.2. |
| Cash Flow Statement                 | Cash flows are the inflows and outflows of cash and cash equivalents.  | 3.2. |
| <b>Classification</b>               |  |      |
| Operating activities                | The activities that form the main source of income, ordinary activities for the Group, as well as other activities that cannot be classified as investment or financing.   | 4.1. |
| Investment activities               | The purchase and disposal of long-term assets, as well as other investments not included in cash and cash equivalents. Only outlays which give rise to the recognition of an asset in the statement of financial position meet the conditions for classification as investment activities. | 4.2. |
| Financing activities                | Those activities which bring about changes in the size and composition of own funds and the loans taken out by the Group.  | 4.3. |
| <b>Information about cash flows</b> |  |      |
| Operating activities                | The Group uses the indirect method, which starts with a gain or loss in net terms, which is then corrected by the effects of non-monetary transactions, for all types of deferred payment items and accumulations (or accruals) which are the cause of receivables                         | 5.1. |



|   |  |      |
|---|--|------|
|   | and payments in the past or in the future, as well as gain or loss items associated with cash flows from operations classified as investment or financing.   |      |
| Investment and financing activities                                 | The Group should report separately on the main categories of gross receivables and payments from investment and financing activities.  | 5.2. |
| <b>Other aspects</b>  |  |      |
| Cash flows in foreign currency                                      | Cash flows from foreign currency transactions will be converted into the entity's functional currency by applying the exchange rate between the two currencies to the amount in foreign currency at the date of each flow in question.   | 6.1. |
| Interest and dividends  | Cash flows corresponding to both the interest received and paid, and the dividends perceived and satisfied, must be disclosed separately. Each of the above items must be classified consistently, period by period, as belonging to operating, investment or financing activities.      | 6.2. |
| Investments in subsidiaries, associates and joint ventures          | When an investment in an associate, a joint venture or a subsidiary is accounted for using the cost or equity method, an investor will limit their information in the cash flows statement to the cash flows between itself and the investee entity, for example dividends and advances. | 6.3. |
| Changes in ownership interests in subsidiaries and other businesses | The aggregate cash flows arising from the acquisition or loss of control of subsidiaries or other businesses must be presented separately and classified as investment activities.   | 6.4. |

### 3. Definitions

#### 3.1. Cash and cash equivalents

Cash is understood as cash in hand and demand deposits in banks.

Cash equivalents are highly liquid short-term investments which are readily convertible into certain amounts of cash and are at little risk to changes in their value.

Cash equivalents have to meet short-term payment commitments more than for investment or similar purposes. For a financial investment to be classified as cash equivalent, it should be:

- Easily convertible into a determined amount of cash and,
- Not be subject to significant risks to changes in value.

Therefore, such an investment will be cash equivalent when it's maturity is close (3 months or less from the acquisition date).

#### 3.2. Cash Flow Statement

Cash flows are the inflows and outflows of cash and cash equivalents.

The cash flow statement represents the Group's ability to generate sufficient liquidity to meet its debts and to make investments.

## 4. Classification

The cash flow statement will report cash flows during the period, classifying them as operating, investment and financing activities.

The classification of flows according to the aforementioned activities provides information which allows users to assess their impact on the financial position of the entity, as well as on the final amount of its cash and other cash equivalents. This information can also be useful in assessing the relationships between such activities.

### Cash flow statement:

- (+) Cash from operating activities
- (+) Cash from investment activities
- (+) Cash from financing activities

### 4.1. Operating activities

The activities that form the main source of income, ordinary activities for the Group, as well as other activities that cannot be classified as investment or financing. Therefore, they come from operations and other events which enter into the determination of net gains or losses.

| Example operating activities   |
|--|
| Receivables from sales of goods and provision of services.   |
| Receivables from fees, commissions and other income from ordinary activities.  |
| Payments to suppliers for the supply of goods and services.  |
| Payments to and on behalf of employees.  |
| Payments or returns of income taxes, unless they can be classified specifically within investment or financing activities. |

### 4.2. Investment activities

The purchase and disposal of long-term assets, as well as other investments not included in cash and cash equivalents. Only outlays which give rise to the recognition of an asset in the statement of financial position meet the conditions for classification as investment activities.

The flows of investment activities represent the extent to which outlays have been made for resources which are expected to produce revenues and cash flows in the future.

| Example investment activities   |
|---|
| Payments for the acquisition of property, plant and equipment, intangible assets and other long-term assets. These terms include those related to the eligible costs defined in the "Property, plant and equipment" and "Intangible Assets" chapters. |
| Receivables for the sale of property, plant and equipment, intangible assets and other long-term equipment.   |

Payments for the acquisition of liability or equity instruments, issued by other entities, as well as shareholdings in joint ventures.

Cash advances and loans to third parties (other than operations of this type made by financial entities).

### 4.3. Financing activities

Those activities which bring about changes in the size and composition of own funds and the loans taken out by the Group.

Included in the financing flow are capital increases received, payments of dividends or capital reductions to shareholders and the change in financial debt.

| Example financing activities   |
|--|
| Receivables arising from the issuance of shares or other capital instruments.  |
| Payments to owners for acquiring shares in the Group.  |
| Receivables arising from the issuance of unsecured obligations, loans, bonds, mortgage bonds and other funds borrowed, whether long or short term. |
| Repayment of funds borrowed.   |
| Payments made by the lessee to reduce outstanding debt from a financial lease.   |

## 5. Information about cash flows

### 5.1. Operating activities

The standard allows for the following methods:

- Direct method: according to which the main categories of gross receivables and payments are presented separately. Under this method, information about the main categories of gross receivables or payments can be obtained by one of the following procedures:
  - a) Using the Group's accounting records
  - b) Adjusting sales and cost of sales, as well as other items in the profit and loss account by:
    - Changes during the period in inventories and accounts receivable and payable arising from operating activities;
    - Other items not reflected in cash; and
    - Other items whose monetary effects are considered investment or financing cash flows.
- Indirect method: the net flow from operating activities is determined by correcting the net gain or loss by the effects of:
  - a) Changes during the period in inventories and accounts receivable and payable arising from operating activities;
  - b) Items not reflected in cash, such as depreciation, provisions, deferred taxes, unrealised gains and losses and participation in undistributed earnings of associates; and
  - c) Any other item whose monetary effects are considered investment or financing cash flows.

The latter is the method used by the Group (see Annex).

## 5.2. Investment and financing activities

The Group should report separately on the main categories of gross receivables and payments from investment and financing activities. Although the rule allows the following to be expressed in net terms:

- Receivables and payments on account of customers, provided that the cash flows reflect the activity of the customer more than that corresponding to the company.
- Receivables and payments from items in which the turnover is high; large amounts and the next maturity.
- Payments and receivables for the acceptance and repayment of deposits with a fixed maturity date.
- Placement and recovery of deposits in other financial institutions.
- Advances and loans made to customers, as well as the repayment of such items.

## 6. Other aspects

### 6.1. Cash flows in foreign currency

Cash flows from foreign currency transactions will be converted into the entity's functional currency by applying the exchange rate between the two currencies to the amount in foreign currency at the date of each flow in question.

Cash flows of a foreign subsidiary will be converted using the exchange rate between the functional currency and the foreign currency at the date of each flow in question.

Unrealised gains or losses on foreign currency exchange differences do not produce cash flows. However, the effect of changes in exchange rates on cash and cash equivalents, held or owed in foreign currency, will be presented in the cash flow statement to enable reconciliation between amounts of cash and cash equivalents at the beginning and end of the period. This amount will be presented separately from the flows from the operating, investment and financing activities, and will include the differences which, if any, would have resulted from having those exchange rate flows presented at the end date.

### 6.2. Interest and dividends

Cash flows corresponding to both the interest received and paid, and the dividends perceived and satisfied, must be disclosed separately. Each of the above items must be classified consistently, period by period, as belonging to operating, investment or financing activities.

The total amount of interest paid during a period will be disclosed in the cash flow statement, whether it has been recognised as an expense in the profit or loss for the period or capitalised, as described in the "Property, Plant and Equipment" chapter.

The Group's policy is to classify interest paid as cash flows from financing activities and interest received as cash flows from investing activities.

### 6.3. Investments in subsidiaries, associates and joint ventures

When an investment in an associate, a joint venture or a subsidiary is accounted for using the cost or equity method (see chapters "Business combinations and goodwill" and "Financial investments"), an investor will limit

their information in the cash flows statement to the cash flows between itself and the investee entity, for example dividends and advances.

An entity that reports on its shareholding in an associate or joint venture using the equity method will include the cash flows from investments in the associate or joint venture in the cash flow statement, as well as distributions and other payments and receivables between both entities.

#### **6.4. Changes in ownership interests in subsidiaries and other businesses**

The aggregate cash flows arising from the acquisition or loss of control of subsidiaries or other businesses must be presented separately and classified as investment activities.

An entity shall disclose, as a whole, in respect of each gain and loss of control of subsidiaries and other businesses during the period, each and every one of the following:

- a) the total consideration paid or received;
- b) the portion of the consideration in cash and cash equivalents;
- c) the amount of cash and cash equivalents in the subsidiaries or other businesses over which the control is gained or lost; and
- d) the amount of assets and liabilities other than cash and cash equivalents in subsidiaries or other businesses over which control is gained or lost, grouped by each main category

### **7. Related regulations**

1. Foreign currency transactions. See module ["Foreign currency transactions"](#)

**8. Annex: Presentation of the Cash Flow Statement**

|   | Year X | Year X-1 |
|---|--------|----------|
| <b>Pre-tax profit/(loss) on continued operations</b>                      |        |          |
| <b>Pre-tax profit/(loss) adjustments on continued operations</b>          |        |          |
| Depreciation and amortisation charge                                      |        |          |
| Other profit/(loss) adjustments (net)                                     |        |          |
| <b>Changes in working capital</b>   |        |          |
| Trade debtors and other accounts receivable                               |        |          |
| Creditors and other accounts receivable and other financial liabilities   |        |          |
| Other non-current assets and liabilities                                  |        |          |
| <b>Other cash flows from operating activities</b>                         |        |          |
| Dividends receivable  |        |          |
| Tax on profits receivable/(payable)                                       |        |          |
| Other receivables/(payables) from operating activities                    |        |          |
| <b>TOTAL NET CASH FLOWS FOR OPERATING ACTIVITIES</b>                      |        |          |
| <b>Payments for investments</b>   |        |          |
| Property, plant and equipment and intangible assets                       |        |          |
| Group companies, associates and business units                            |        |          |
| Other financial assets  |        |          |
| <b>Other receivables/(payables) from investment operations</b>            |        |          |
| Interest receivable   |        |          |
| Other receivables/(payables) from investment activities                   |        |          |
| <b>Receivables from divestments</b>                                       |        |          |
| Group companies, associates and business units                            |        |          |
| Property, plant and equipment, intangible assets                          |        |          |
| Other assets  |        |          |
| <b>TOTAL NET CASH FLOWS FOR INVESTMENT OPERATIONS</b>                     |        |          |
| <b>Equity instrument receivables and (payables)</b>                       |        |          |
| <b>Receivables (payables) relating to financial liability instruments</b> |        |          |
| <b>Dividends payable and remuneration on other equity instruments</b>     |        |          |
| <b>Net interest</b>   |        |          |
| <b>Other receivables/(payables) from financing operations</b>             |        |          |
| <b>TOTAL NET CASH FLOWS FOR FINANCING OPERATIONS</b>                      |        |          |
| Effect of exchange rate variations and others                             |        |          |
| <b>TOTAL NET CASH FLOWS FOR THE YEAR</b>                                  |        |          |
| Initial cash and cash equivalents balance                                 |        |          |
| <b>FINAL CASH AND CASH EQUIVALENTS BALANCE</b>                            |        |          |

# Accounting policy manual

## Business combinations and goodwill

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## Business combinations and goodwill

### 1. Scope

This policy includes the accounting treatment of business combinations as well as the determination of goodwill.

The accounting criteria under this policy are derived from the application of the following international regulation:

| IAS / IFRS | Description           |
|------------|-----------------------|
| IFRS 3     | Business Combinations |

### 2. Executive Summary

| Area  | Concepts  | Ref. |
|---|---|------|
| <b>Definition of business combinations</b>                    |   |      |
| Business combinations   | Transaction or event in which an acquirer obtains control of one or more businesses.  | 3    |
| Business  | An integrated set of activities and assets which can be directed and managed for the purpose of providing a return to investors in the form of dividends, lower costs or other economic benefits.   | 3    |
| <b>Recognition of business combinations</b>                   |   |      |
| Recognition   | Business combinations must be recorded using the acquisition method.  | 4    |
| Acquisition method  | The acquisition method consists of the following steps: 1. Determining if the transaction is a business combination, 2. Identifying the acquiring company, 3. Determining the acquisition date, 4. Recognising and value the assets acquired and liabilities assumed. 5. Determining the cost of the combination, 6. Recognising and value any minority interest, 7. Determining the goodwill or negative difference. | 4    |
| Determining if the transaction is a business combination      | A transaction is a business combination if the set of assets acquired constitute a business.  | 4.1. |
| Identify the acquiring company                                | That which obtains control of the other entities or businesses in the combination. As a general rule, an acquirer will be considered whomever delivers a consideration in exchange for the acquired business.   | 4.2. |
| Determining the acquisition date                              | The date on which the acquirer obtains control over the acquired company and therefore the date from which the operations of the acquired party form part of the acquirer's consolidated business.  | 4.3. |
| Identification of the assets acquired and liabilities assumed | Those assets and liabilities acquired as a separate part of the goodwill will be recorded to the extent they comply with: 1. The definitions of assets and liabilities of the conceptual framework and 2. Are exchanged as part of a business combination and not a separate transaction.   | 4.4. |
| Valuation of the assets acquired and liabilities assumed      | As a general rule they will be measured at their fair values on the acquisition date.   | 4.4. |

|   |  |      |
|---|--|------|
| Determination the cost of the combination         | The cost of the combination will be the sum of the fair value of the consideration given and the fair value of any contingent consideration.   | 4.5. |
| Recognition of external partners                  | Minority interests represent the percentage of a subsidiary which is not directly or indirectly attributable to the parent company.  | 4.6. |
| Valuation of external partners                    | Minority interests are measured at fair value of the net assets existing at the date of the combination.   | 4.6. |
| Determination the goodwill or negative difference | If the difference between the cost of the combination and the fair value of net assets is positive goodwill arises; on the contrary, if it is negative, a negative difference arises.  | 4.7. |
| Definition of goodwill                            | Set of intangible assets which imply value for the company, in the sense of being a differential factor which allows generation of future income.  | 4.7. |
| Valuation of goodwill                             | Goodwill is initially measured at cost, which is the excess of the cost of the business combination over the net fair value of the identifiable assets and contingent liabilities acquired. This should be assigned to the CGU or CGUs which benefits from the synergies of the combination. | 4.7. |
| <b>Adjustments in the valuation period</b>        |  |      |
| Valuation period                                  | 12 months from the acquisition date to carry out the valuation and registration of the business combination.   | 5    |
| Recognition of the adjustments                    | Adjustments arising in the valuation period will be adjusted retroactively. Subsequent adjustments will only be registered to rectify an error, otherwise they will be made according to the corresponding standard.   | 5    |
| <b>Subsequent valuation of goodwill</b>           |  |      |
| Subsequent valuation of goodwill                  | An impairment test is performed annually (see chapter "Impairment on tangible and intangible assets, and goodwill").   | 6    |
| Derecognition of goodwill                         | Goodwill has to be derecognised by the part of the CGU which has been disposed of.   | 7    |

### 3. Definition of a business combination

The standard defines a business combination as a transaction or other event in which an acquirer gains **control** of one or more businesses.

In this sense, a **business** should be understood as an integrated set of activities and assets which can be directed and managed for the purpose of providing a return to investors in the form of dividends, lower costs or other economic benefits. A business generally consists of a set of:

- Inputs: economic resources which when one or several processes are applied generate or have the capacity to generate products. Some examples of inputs would be: non-current assets, intellectual property, ability to access materials or rights, and employees.
- Processes: they are systems, norms, protocols, conventions, rules which when applied to the inputs, give products. Some examples of processes would be: strategic, productive or resource management processes.
- And products: result of the application of processes to inputs and which provide or have the ability to provide a return in the form of economic benefits.

An investor controls an investee when it is exposed, or entitled to, variable returns from their involvement in the investee and has the ability to influence those returns through their power over it. Therefore, an investor controls an investee if and only if it has all of the following elements:

- a) power over the investee;
- b) exposure, or right, to variable returns from their involvement in the investee; and
- c) ability to use their power over the investee to influence the amount of investor returns

A business combination, depending on the legal form used, can originate as a consequence of:

- Fusion or demerger of companies.
- Acquisition of all a company's assets or a part which constitutes one or more businesses.
- Acquisition of a company's shares or shareholdings (can be by virtue of non-monetary contributions).
- Other operations whose result is that a company which previously or not has a stake in the capital of a company, acquires control without making an investment.

## 4. Recognition of business combinations

Business combinations must be recorded using the **acquisition method**, which requires the acquiring company on the acquisition date, in the consolidated books, to account for:

- Identifiable assets acquired and liabilities assumed in the combination,
- where appropriate, the corresponding goodwill or negative difference.

Specifically, the acquisition method requires:

1. Determining if the transaction is a business combination.
2. Identifying the acquiring company.
3. Determining the acquisition date.
4. Recognising and valuing the identifiable assets acquired and liabilities assumed.
5. Determining the cost of the combination.
6. Recognising and valuing any minority interest.
7. Determining the goodwill or negative difference.

### 4.1. Determination of if the transaction is a business combination

For each transaction, the Group must determine whether it is a business combination, in particular, if all the assets acquired constitute a business (see section 3). Otherwise, the acquisition method will not apply, and the transaction must be accounted for as an asset acquisition, and, if applicable, liability assumption. Also, those indicated in section 4.2 are determinants of if the transaction is a business combination.

#### Examples

| Description of the situation  | Is a business acquired? |
|---|-------------------------|
| A company is acquired without staff and whose only asset is a building.   | ✗                       |
| A company is acquired in which 60 people work and 3 owned hotels operate in the Canary Islands.   | ✓                       |
| A dormant company is acquired for future legal use for company restructuring.   | ✗                       |
| A group / company which owns hotel properties is acquired whose exploitation was already carried out by Grupo NH in the past through leases | ✗                       |

|   |   |
|---|---|
| A group / company which owns hotel properties is acquired whose exploitation was already carried out by Grupo NH in the past through management | ✓ |
| 25% of the capital of a company which operates an owned or leased hotel in which Grupo NH already holds 55% of the capital.                     | ✗ |
| 25% of the capital of a company which operates an owned or leased hotel in which Grupo NH already holds 30% of the capital.                     | ✓ |

## 4.2. Identification of the acquiring entity

The acquiring company is that which obtains control of the other entities or businesses in the combination. As a general rule, an acquirer will be considered whomever delivers a consideration in exchange for the acquired business but is not the sole criterion which should be considered as other factors which should be taken into account are:

| Factor   | The acquirer is:   |
|--|--|
| Voting rights in the combined entity after the combination.                              | Usually the entity whose owners, as a group, retain or receive the greater proportion of the voting rights of the combined entity.                                       |
| Composition of the governing body of the combined entity.                                | Usually the entity whose owners have the ability to choose or appoint the majority of the members of the governing body.   |
| Senior management of the combined entity.  | Usually the entity which has the authority to designate the management team of the combined company or those whose (former) managers mainly manage the combined company. |
| Conditions for the exchange of shareholdings.  | Usually the entity which pays a premium over the fair value before the combination of the other entity or entities.  |
| The consideration is made mainly in cash, through other assets or incurring liabilities. | Generally, the entity which transfers the cash or other assets, or which incurs liabilities.   |

## 4.3. Determination of the acquisition date

The date on which the acquirer obtains control over the acquired company and therefore the date from which the operations of the acquired party form part of the consolidated business. As a result, goodwill is identified and net assets are accounted for at fair value only with respect to the transaction with which control has been taken, and not in relation to prior or subsequent acquisition of shareholdings.

## 4.4. Identification and measurement of the assets acquired and liabilities assumed

The recognition criterion of IFRS 3 establishes that those assets and liabilities acquired as a separate part of the goodwill will be recorded to the extent they comply with:

- The definitions of assets and liabilities of the conceptual framework; and
- Are exchanged as part of a business combination and not a separate transaction.

Thus, as part of the business combination, assets and liabilities which may not be recognised in the balance sheet of the acquiree may be recognised as internally generated intangible assets, such as brands, contractual relationships with customers or suppliers (owners of leased hotels), customer portfolios or ongoing research and development assets.

In the case of leases in which the acquiree is lessee of a contract, an intangible asset or a liability for the favourable/unfavourable conditions of the said contract in relation to the market will be recognised.

### Example

Company A acquires company F in a business combination on 31 January X+2. F entered into an operating lease contract for a leased property in year X. The rent is fixed for a period of 3 years and is substantially lower than the market price on the acquisition date. The contract has an estimated fair value of 500 monetary units which includes consideration for the renewal operations. A recognises an intangible asset for 500 monetary units separately from goodwill.

As a general rule, the acquirer measures the acquired identifiable assets and the liabilities assumed at their **fair value** on the acquisition date. Understood as fair value is the amount for which an asset may be exchanged or a liability settled between interested and duly informed buyers and sellers, under conditions of mutual independence. Best estimates and the most suitable methods should be used for their valuation. In such cases, the methods and assumptions used for the calculation of fair values should be checked with the Accounting Policy Director.

There are some exceptions to the principle of recognition and valuation:

| Exceptions to recognition and/or valuation                  |   |
|---|---|
| Non-current assets classified as held for sale              | At fair value less costs to sell.   |
| Deferred tax assets and liabilities                         | Pursuant to IAS 12.   |
| Assets and liabilities for employee remuneration agreements | According to IAS 19, that is to say, the present value of the remunerations committed, less the fair value of the assets affected.  |
| Assets for indemnity  | It may be agreed in the combination that the seller contractually indemnifies the buyer in case of contingency or uncertainty of an asset or liability (for example, compensation in case a tax contingency exceeds a certain amount).<br>The acquirer must recognise an asset for indemnity at the same time and in a manner consistent with the covered element which generates the aforementioned contingency or uncertainty.  |
| Rights reacquired   | The acquirer will value a reacquired right recognised as an intangible asset on the basis of the contractual period remaining until its completion, regardless of whether a third party considers any contractual renewals in the determination of their fair value.  |
| Share-based payments  | Pursuant to IFRS 2.   |
| Obligations classified as contingencies                     | They will be recognised at fair value, provided it is a present obligation which arises from past events and its fair value can be reliably measured, even though it is not probable that there would be an outflow of resources in order to settle the obligation.<br>Restructuring costs which the buyer decides were not approved and communicated by the seller will not be a liability assumed, and therefore cannot count against goodwill, but they are post-acquisition expenses and therefore accrue after the date of the business combination. |

#### 4.5. Determination the cost of the combination

In general, the consideration given will be the cash or assets delivered or the liabilities incurred (for example: cash paid, issue of shares, delivery of assets, assumption of liabilities, etc.). In this sense, any contingent consideration whose realisation does not depend on a future event and which must be recorded as an asset, liability or equity according to its nature must be included. Also, the remuneration delivered which does not form part of the transfer of control will be excluded from the calculation. This is:

**Cost of the combination:**

- (+) Fair value of the consideration delivered
- (+) Fair value of any contingent consideration

If the consideration is deferred over time, it will be measured at fair value, which will correspond to the present value of the deferred consideration discounted at a market interest rate for a similar instrument from an issuer with a similar credit rating. Subsequently, the amount of the financial effect will be recognised in profit or loss.

The following limitations exist when determining the cost of the combination:

- If the fair value of the business acquired is more reliable, it will be used instead of the consideration delivered.
- Unless there is a more reliable valuation, the fair value of equity instruments or financial liabilities issued will be the listed price.

The acquirer must identify what amount is part of the consideration paid as exchange for the control and which sums are not part of this exchange. It should be assessed if there are elements other than the transfer of control such as the following:

- Pre-existing relationships.
- Remuneration to employees or owners of the old company for future services.
- Refunds for the transaction costs.

The acquirer will account for costs related to the acquisition (search fees, advice, legal, accounting, valuation and other professional or consultancy fees, general administration costs, including the costs of maintaining an internal acquisitions department, and registration and issuance of debt and shares costs) as expenses in the years in which said costs were incurred. The costs of debt or share issues should be recognised pursuant to IAS 32 and 39.

#### **4.6. Recognise and value the minority interest (external partners) in the acquiree**

Minority interests represent the percentage of a subsidiary which is not directly or indirectly attributable to the parent company.

Minority interests are measured at fair value of the net assets existing at the date of the combination, excluding goodwill, which is.

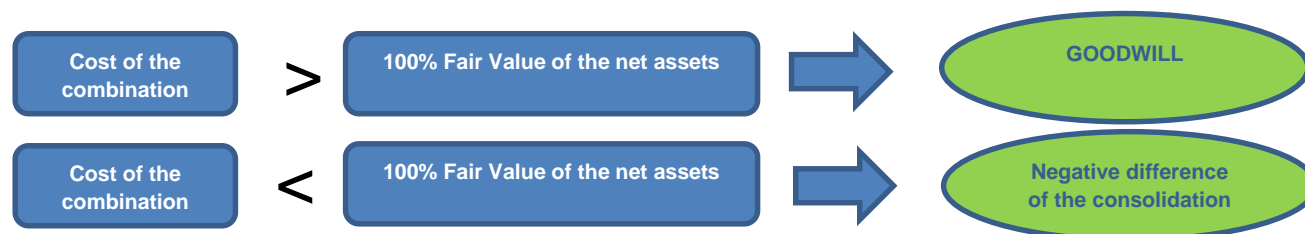
$$\text{External partners} = \text{Net assets at fair value} \times \% \text{ shareholding}$$

#### **4.7. Determination the goodwill or negative difference**

It is defined as the set of intangible assets, such as the customers, name or business name, location, market share and amount of company competition, human capital, commercial channels and others of a similar nature which imply value for the company, in the sense of being a differential factor which allows generating income in the future.

Goodwill acquired in a business combination is initially measured at the time of acquisition at its cost, which is the excess of the cost of the business combination over the net fair value of the identifiable assets and contingent liabilities acquired.

In the event that the fair value of the assets acquired and liabilities assumed is greater than the amount of the consideration, the difference is recognised as a profit of the year. If this is reversed, Goodwill will be recognised:



Once the goodwill derived from the business combination has been determined, it should be assigned to the CGU or groups of CGUs (usually hotels for the Group) which benefit from the synergies of the combination. The CGU or groups of CGUs to which the goodwill is assigned must represent:

- The lowest level within the entity for which information is available on goodwill and which is controlled for internal management purposes; and
- Not be greater than an operating segment, determined pursuant to IFRS 8 before applying the aggregation criteria of that standard.

## Example calculation of goodwill with minority shareholders

Company A acquires 60% of B in exchange for a cash consideration of 85. At the acquisition date, the fair value of B's identifiable net assets was 120.

### 1. Calculation

$$120 \times 60\% = 72$$

$$85 - 72 = 13$$

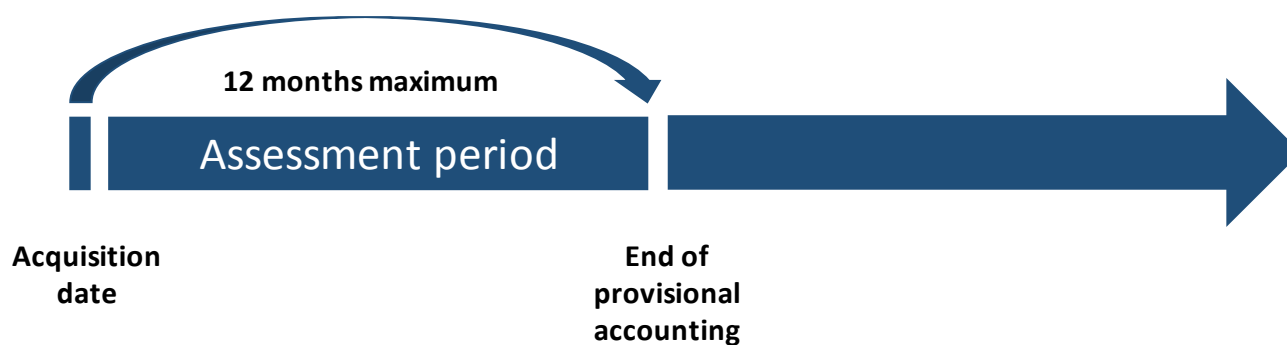
### 2. Entry in the first consolidation

| Description                    | Debit | Credit |
|--------------------------------|-------|--------|
| Db. Net assets acquired        | 120   |        |
| Db. Goodwill                   | 13    |        |
| Cr. Banks                      |       | (85)   |
| Cr. Equity (external partners) |       | (48)   |

## 5. Recognition of the adjustments arising in the valuation period

The transaction must be registered as soon as it is completed, this registration is made at provisional values which are subject to revision as a result of an improvement of the information available and the analysis performed during the following 12 months.





Adjustments arising in the valuation period derived from information related to the acquisition date will be adjusted by restating the comparative financial statements as if the said information had been available at the date on which the business combination was accounted for, that is, the adjustments in the valuation period are retroactive, as if they were made on the initial date.

Adjustments after the valuation period will only be recorded to rectify an error, all other adjustments will be made according to that stated in the corresponding standard.

## 6. Subsequent valuation of goodwill

Goodwill is not amortised, although the possible deterioration of its economic value is analysed annually. Goodwill should be assigned to cash-generating units. Its recoverable value should be checked annually (see chapter ["Impairment of non- current assets"](#)).

## 7. Derecognition of goodwill

If one of the CGUs assigned goodwill is disposed of, the part of the goodwill assigned to them must be included in determining the gain or loss of the CGU or group of CGUs. The part to be derecognised is determined based on the values related to the disposed activity and the part of the CGU or CGUs which is maintained, except when another method exists which better reflects the goodwill associated with said activity. In the case of business reorganisations, the goodwill will be reassigned using the same criteria.

## 8. Related regulations

1. Impairment of Goodwill See module ["Impairment of non- current assets"](#)

## 9. Practical example

The company of Group A has acquired 100% of company B, which was a franchisee of the company A. On the acquisition date, company B represented the following financial situation:

| Assets                        | Amount         | Liabilities              | Amount           |
|-------------------------------|----------------|--------------------------|------------------|
| Intangible asset              | 50,000         | Share capital            | (100,000)        |
| Property, plant and equipment | 300,000        | Legal                    | (400,000)        |
| Inventories                   | 100,000        | Profit (Loss)            | (100,000)        |
| Bank                          | 200,000        | Suppliers                | (50,000)         |
| <b>Total Assets</b>           | <b>650,000</b> | <b>Total Liabilities</b> | <b>(650,000)</b> |

The amount paid by A for the acquisition of B amounted to 1,000,000 monetary units. It is further known that:



- The reacquired franchise rights are valued at 50,000 monetary units.
- B had entered into an operating lease contract for a premises at a price substantially lower than the market price at the acquisition date. The contract has an estimated fair value of 20,000 monetary units which includes consideration for the renewal operations.
- The property, plant and equipment of B comprise land whose fair value amounts to 200,000 monetary units compared to the 100,000 monetary units which appears in the financial statements.

## **1. Identification and measurement of the assets and liabilities assumed**

| Element                                   | Amount         |
|---|----------------|
| Intangible asset                          | 50,000         |
| Property, plant and equipment             | 300,000        |
| Inventories                               | 100,000        |
| Bank                                      | 200,000        |
| Suppliers                                 | (50,000)       |
| Reacquired franchise rights               | 50,000         |
| Lease contracts                           | 20,000         |
| Greater value of land                     | 100,000        |
| <b>Total fair value of the net assets</b> | <b>770,000</b> |

## **2. Determining the cost of the consideration: 1,000,000 monetary units.**

## **3. Calculation of goodwill**

Goodwill= Value of the consideration - Fair value of the net assets

Goodwill= 1,000,000 – 770,000 = 230,000 monetary units

## **4. Accounting entry to recognise the business combination**

| Description                              | Debit   | Credit    |
|--|---------|-----------|
| Db. Rights reacquired (intangible asset) | 50,000  |           |
| Db. Lease contracts                      | 20,000  |           |
| Db. Other identifiable net assets        | 700,000 |           |
| Db. Goodwill                             | 230,000 |           |
| Cr. Consideration transferred            |         | 1,000,000 |

# Accounting policy manual

## Intangible Assets

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Approved by:

SVP Consolidation and  
Internal Control

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## Intangible Assets

### 1. Scope

This accounting policy will be applicable to the acquisitions of intangible assets used by the Group, except for consolidated goodwill whose treatment is included in the "Business Combinations and Goodwill" chapter. By definition these assets have no monetary value and lack physical form. The acquisition and/or development of the following assets will be within the scope of this policy:

- Rights of usufruct
- Rental agreement premiums
- Concessions, patents and trademarks
- Computer software
- Goodwill (see chapter "Business combinations and goodwill")

The accounting criteria under this policy are derived from the application of the following international regulation:

| IAS / IFRS | Description       |
|------------|-------------------|
| IAS 38     | Intangible assets |

### 2. Executive Summary

| Area   | Concepts  | Ref.   |
|--|---|--------|
| <b>Initial recognition</b>   |   |        |
| Initial costs  | Intangible assets are recognised at their acquisition cost.   | 3.1.   |
| Acquisition cost   | The acquisition cost is understood at the acquisition price including import duties and non-recoverable taxes on acquisition after deducting trade discounts and rebates as well as any direct cost attributable to preparing the asset for its expected use. | 3.1.   |
| Concepts included in the acquisition cost recorded as fixed assets             | Capitalisation costs are those which meet with the definition of an asset.  | 3.1.1. |
| Concepts excluded from acquisition cost which should be recorded as an expense | Those which do not meet the definition of an asset, as well as research and internal trademark generation expenses.   | 3.1.1. |
| Rights of usufruct   | Recognised as the full amount agreed as the operation price.  | 3.2.1. |
| Rental agreement premiums  | Recognised as the amount paid to the lessee for obtaining a lease contract.   | 3.2.2. |
| Concessions, patents and trademarks  | Recorded as the costs incurred to obtain the property or the right to use the property.   | 3.2.3. |
| Computer software  | They include those acquired from third parties by their acquisition cost, as well as those carried out internally by the expenses incurred which are directly attributable to the asset.  | 3.2.4. |
| <b>Subsequent valuation</b>  |   |        |

|  |   |        |
|--|---|--------|
| Amortisation                             | The amortisations reflect the ordinary depreciation suffered by the asset as a result of the use of intangible assets in the course of the Group's activities.  | 4.1.   |
| Useful lives                             | The Group amortises intangible assets in accordance with the estimated useful life of each.   | 4.1.1. |
| Start of amortisation                    | The start of amortisation coincides with the date on which the asset is available for use.  | 4.1.2. |
| Calculation of amortisations             | Amortisation of intangible assets is calculated by dividing the depreciable base of the asset by its useful life. Depreciable base is understood as the cost of the asset minus its residual value.   | 4.1.3. |
| Amortisation method                      | The straight line method is used as it reflects the pattern of the economic benefits associated with intangible assets. Any modification to this method must be approved by the Group's Accounting Policy Director.   | 4.1.4. |
| Termination of amortisation              | Occurs on the date the asset is derecognised or when fully amortised.   | 4.1.5. |
| Modification of the useful life estimate | Periodically, the useful life is revised centrally in Grupo NH by the Group's Accounting Policy Director.   | 4.1.6. |
| Impairment of intangible assets          | This section is developed in the Chapter "Impairment on tangible and intangible assets, and goodwill".  | 4.2.   |
| Subsequent costs                         | Can only be recorded as an increase in the initial cost if the general criteria applicable to the initial recognition of an intangible asset and the definition of an intangible asset are considered to have been met.   | 4.3.   |
| <b>Derecognition of fixed assets</b>     |   |        |
| Derecognitions                           | The derecognition of intangible assets as a result of their disposal or the cessation of their use or permanent impairment will determine the recognition of a result equivalent to the difference between the amount to be received from a third party, and the net book value of the asset. | 5      |
| <b>Other aspects</b>                     |   |        |
| Revaluations                             | Revaluations of intangible assets are prohibited by the Group.  | 6.1.   |

### 3. Initial recognition

Intangible assets are considered to be any specifically identifiable non-monetary assets which have been acquired from third parties or developed by the Group. Only those whose cost can be estimated in an objective way and from which future economic profits are expected are recognised.

These criteria will normally be met in the context of goods acquired in a business combination and in the separate acquisition of intangible assets, and further evidence will be required for internally developed intangible assets.

The condition of being identifiable will be fulfilled if the asset is separable, i.e., if it can be sold, split, transferred, leased by itself or under a contract, or arises from legal or contractual rights.

Likewise, it is necessary for there to be control over it by the Group insofar that access by third parties to benefits generated by the asset can be restricted.

### 3.1. Initial costs

As a general rule, the various elements understood as intangible assets are valued at their acquisition price.

Acquisition price is that invoiced by the supplier plus all necessary expenses to obtain ownership and its commissioning.

The acquisition cost of an intangible asset is understood as:

- a) The acquisition cost is understood at the acquisition price including import duties and non-recoverable taxes on acquisition after deducting trade discounts and rebates; and
- b) any direct cost attributable to preparing the asset for its expected use.

#### 3.1.1. Activation of expenses

Capitalisable concepts are those which fulfil the definition of an asset as detailed in point 3 above. These expenses must be duly justified and individualised per employee, and be approved in advance by the Group's Accounting Policy Director.

In regard to **research and development** expenses, the standard provides that when an intangible asset is produced internally, the outlays which can be directly attributed to the development will be capitalised from such time as the requirements detailed in the standard can be shown, although the group does not consider the capitalisation of these expenses.

Specifically, as established in the standard, the following concepts are considered capitalisable expenses:

| Capitalisable concepts  |
|---|
| Costs related to employee benefits directly related to the acquisition or internal generation of fixed assets, such as salaries, bonuses or share-based payments, social security and other social costs. |
| Professional fees related to the development of computer software.  |
| Costs of checking that the asset performs correctly.  |
| Cost of developing non-advertising web pages (infrastructure development; design and content) which fulfils the requirements to be considered development expenses.                                       |

Conversely, not considered capitalisable expenses are:

| Non-capitalisable concepts  |
|---|
| Formation expenses.   |
| <b>Know-how of processes acquired in business combinations.</b>             |
| Costs of maintaining computer software where no new functionality is given. |
| Staff training expenses.  |
| Research and development expenses   |
| Internally generated trademarks.  |
| Costs of developing advertising content on web pages.                       |

Costs incurred when the asset, capable of being used as expected, has not begun to be used.

Initial operating losses, such as those generated while developing stock of products produced with the asset.

In summary, the acquisition cost is calculated as follows:

**Cost of an intangible asset:**

- (+) Amount invoiced by the supplier
- (+) Costs incurred until in working conditions
- (+) Non-recoverable taxes incurred
- (+) Internal work

**Not included in the cost of an intangible asset:**

- Expenses of training employees in the correct use of the asset.
- Recoverable taxes

### Accounting Entries

The accounting entries to be made on the day the asset is received are:

| Debit   |   | Credit   |
|---|---|--|
| (20x) Intangible fixed assets   |   |  |
|   | a | (570) Treasury <b>(i)</b>  |
|   |   | (511) Suppliers of the fixed assets <b>(ii)</b>                    |
|   |   | (730) Works carried out on the intangible fixed asset <b>(iii)</b> |
| <b>(i)</b> By the amounts paid  |   |  |
| <b>(ii)</b> By the amount outstanding                                   |   |  |
| <b>(iii)</b> By the works carried out internally, previously authorised |   |  |

## 3.2. NH Hotel Group Specific Considerations

### 3.2.1. Rights of usufruct

This heading records the amount paid to the owner for the constitution of rights of usufruct on a property. Consequently, the initial costs would be the full amount agreed as the operation price.

### 3.2.2. Rental agreement premiums

Rental agreement premiums are amounts paid to third parties other than the lessee as a condition for obtaining certain hotel lease contracts. This amount **DOES NOT** include payments made to landlords from the signing of the agreement until the hotels start operating. These payments are considered expenses in the period in which they occur.

### 3.2.3. Concessions, patents and trademarks

Corresponds to the costs incurred in obtaining the property or the right to use the industrial property with the aim of obtaining the concession.

### 3.2.4. Computer software

Computer software includes both that acquired from third parties as well as that developed internally if it complies with the requirements mentioned in section 3.1.1.

#### Example

The Group's systems department staff have been developing an new application which will allow suppliers to record their invoices on the system. The development costs for this application so far reach €400,000 as follows:

| Concept                        | Amount  |
|--------------------------------|---------|
| User training                  | 50,000  |
| Help desk to solve issues      | 40,000  |
| Development of the application | 250,000 |
| Cost to implement in hotels    | 60,000  |
|                                | 400.000 |

The entry to record is as follows:

| Account | Description                                   | Debit   | Credit  |
|---------|---|---------|---------|
| 2150    | Computer software                             | 310,000 |         |
| 7320    | Work carried out by the company for its asset |         | 310,000 |

Both the costs of training staff on the application and the setting up of a help desk do not comply with the requirements on an asset and there should be recorded as expenses in the year in which they occur.

## 4. Subsequent Valuation

The subsequent valuation of intangible assets will be by its "Net book value"; defined in the following manner:

#### Intangible asset net book value:

- (+) Acquisition cost
- (-) Cumulative amortisation/depreciation
- (-) Impairment or loss of value

### 4.1. Amortisation

After initial recognition, the intangible asset will be amortised along its useful life according to the chosen method.



The Group's intangible assets are amortised using the straight line method.

The criteria for estimating amortisation: useful life and amortisation method will be periodically revised by the Group's Accounting Policy Director.

The amortisations reflect the ordinary depreciation suffered by the asset as a result of the use of intangible assets in the course of the Group's activities.

#### 4.1.1. Useful lives

Intangible assets are classified based on whether they have a defined or indefinite useful life as this will determine if they can be amortised or not. The Group will consider an intangible asset as having an indefinite useful life when, based on all relevant factors, there is no foreseeable limit over which the asset is expected to generate net cash inflows for the Group.

Intangible assets currently registered in Grupo NH's financial statements are classified as having a defined useful life. The identification of intangible assets as having an indefinite useful life will, in any case, require the necessary consultation and authorisation from the Group's Accounting Policy Director.

Many factors are considered in determining the useful life of an intangible asset such as those highlighted below:

Internal:

- Expected use of the asset and the maintenance it requires
- Dependence on other factors; and
- Product life cycle

External:

- Period of validity of the agreement or contract or corresponding legislation (considering existing renewal periods provided there is evidence)
- The stability of the market, activity, competition; and
- Technical, commercial, technological obsolescence

The useful lives as used by the Group are shown below:

| Concept                              | Useful life  |
|--------------------------------------|--|
| Rights of usufruct                   | According to duration of usufruct contract.            |
| Rental agreement premiums.           | According to most likely duration of rental agreement. |
| Concessions, patents and trademarks. | According to duration of concession contract.          |
| Computer software.                   | 4 years  |

#### 4.1.2. Start of amortisation

Amortisation of an intangible asset begins when it is available for use. The moment at which an asset is understood to be in use varies according to the type of asset; specifically, for Grupo NH:

- Computer software, concessions, patents and trademarks: as a general rule, they are understood to be available for use at the time of their activation. For computer software developed internally, amortisation

starts when the project is concluded by the Systems Department regardless of if it is used from this date or not.

- Rights of usufruct and rental agreement premiums: amortisation starts when the contract begins.

Likewise, Group policy is to start amortising assets from the first day of the month following their registration.

#### 4.1.3. Calculation of amortisations

Amortisation of intangible assets is calculated by dividing the depreciable base of the asset by its useful life. Depreciable base is understood as the cost of the asset minus its residual value.

Based on the Group's experience, the residual value of the various elements which make up the intangible asset will be considered negligible for the purposes of calculating amortisation. In any case, the use of a residual value other than zero should be approved by the Group's Accounting Policy Director.

$$\text{Amortisable basis of intangible asset} = \text{Cost of intangible asset}$$

The one-month amortisation rate will therefore be calculated as follows:

$$\text{Amortisation rate of the period (month):} \quad \frac{\text{Amortisable basis}}{\text{Years of useful life}} \times 1/12 \text{ months}$$

#### 4.1.4. Amortisation methods

The amortisation methods applied should reflect the consumption pattern of the economic benefits associated with the asset.

Different methods may be used to systematically distribute the depreciable amount of an asset over its useful life. These methods include the straight line method, declining balance, and production units. The method used will be chosen from the expected consumption pattern of the future expected economic benefits in the asset and will be applied consistently from one period to another unless there is a change in the expected consumption patterns of said future economic benefits. If the pattern cannot be reliably determined, the straight line amortisation method will be used.

In this sense, the Group has adopted **the straight line application criterion** as is it that which best reflects the economic life of the asset and for its being the most commonly applied method in the industry. The use of an amortisation method other than the straight line method will require prior consultation and authorisation from the Group's Accounting Policy Director.

#### Example

By way of an example, suppose the Group acquired computer software on 1 January for €1,000 with an estimate useful life set at 4 years. The residual value at the end of the fourth year is considered negligible. In these circumstances, the application of the straight line method would determine a constant amortisation as shown in the table.

| Year 1 | Year 2 | Year 3 | Year 4 |
|--------|--------|--------|--------|
| 250    | 250    | 250    | 250    |

#### 4.1.5. Termination of amortisation

The termination of amortisation of the different elements which make up the intangible asset must occur on the date on which the asset is derecognised or when it is fully amortised.

The accounting standard establishes that in early termination of amortisation an impairment provision should be made for its full net book value. However, given that the Group's systems do not allow for this operation, in the case of an impairment provision, the monthly amortisation will continue on the straight line and at the end of the year an adjustment will be made to settle the amortisation recorded.

#### 4.1.6. Modification of the useful life estimate

The useful life has to be revised centrally by Grupo NH with the aim of identifying if there are any circumstances which could give rise to changing the initial criteria. Changes in useful life will be communicated to the Group's Accounting Policy Director who will mark the reasons which justified the change and the criteria which should be made by the various Business Units affected. Therefore, the useful life of no element category can be changed without prior consultation and express authorisation from the Group's Accounting Policy Director.

### 4.2. Impairment on Intangible Assets

This section is developed in the Chapter "Impairment on tangible and intangible assets, and goodwill".

#### 4.3. Subsequent costs

Expenses incurred subsequent to initial recognition can only be recorded as part of its cost if the general criteria applicable to the initial recognition of an intangible asset and the definition of an intangible asset are considered to have been met.

As a general rule, subsequent outlays of intangible assets are not considered to meet the above requirements, given that such outlays are normally made to maintain the expected economic benefits of said assets. Subsequent costs will not be capitalised except when they represent an extension of a right acquired by the Group.

### 5. Derecognition of intangible assets

Derecognition of intangible assets may occur for the following reasons:

- Sale of the asset
- Definitive end of its use
- Permanent loss of value

The derecognition of the various assets will be made at their net book value. The derecognition of the various assets recorded in the intangible asset accounts will determine the recognition of a result equivalent to the difference between the amount receivable and the net book value of the asset. Income related to the sale will be considered net of the incremental costs directly attributable to the transaction, such as legal fees, taxes or costs related to the withdrawal.

Results arising from the sale: Gain (+) / Loss (-): Sale price - (Cost of asset sold - Cumulative amortisation - Provision for value impairment)

## 6. Other aspects

### 6.1. Revaluations

The standard contemplates that, subsequent to initial recognition, although the existence of an active market is rare, an intangible asset can be accounted for at its revalued value, which is its fair value at the time of revaluation, less cumulative amortisation, and the cumulative amount of the impairment losses of the value they have suffered. However, revaluations **are prohibited by the Group**.

### 6.2. Grupo NH Policy

Ultimately, in its activity's ordinary situations, Grupo NH will account for intangible assets as it has been doing, and in exceptional circumstances will require the authorisation of the Group's Accounting Policy Director as detailed below:

| Approval by the Accounting Policy Director                         |
|--|
| Use of an amortisation method other than the straight line method. |
| Changing useful lives.   |
| Capitalisation of internally generated costs                       |

And in any event, the following will be prohibited:

| Prohibited                                       |
|--|
| Activation of research and development expenses. |
| Revaluation of intangible assets.                |

## 7. Related regulations

1. Operational and financial leases. See module [“Operational and Financial Leases”](#)
2. Property, plant and equipment See module [“Property, plant and equipment”](#)
3. Goodwill. See module [“Business combinations”](#)
4. Impairment on intangible assets. See module [“Impairment on Tangible and Intangible Assets, and Goodwill”](#)

## 8. Practical example

The following example is offered for illustrative effects to show the most frequent accounting entries in the accounts of the module:

### 1. Initial recognition at acquisition:

The Entity acquires computer software on 1 January for 2,500 euros. In our example, we propose two possible situations when making the purchase: a) the Entity settles in cash on the acquisition date; or b) payment for the software happens two months after acquisition.

- a. Cash settlement:

| Debit |                         |   | Credit               |
|-------|-------------------------|---|----------------------|
| 2,500 | (206) Computer software |   |                      |
|       |                         | a | (570) Treasury 2,500 |

b. Payment made subsequent to the software acquisition:

b.1. At the time of acquisition:

| Debit |                         |   | Credit  |
|-------|-------------------------|---|---|
| 2,500 | (206) Computer software |   |   |
|       |                         | a | (511) Accounts receivable from fixed assets 2,500 |

b.2. At the time of payment

| Debit |   |   | Credit               |
|-------|---|---|----------------------|
| 2,500 | (511) Accounts receivable from fixed assets |   |                      |
|       |   | a | (570) Treasury 2,500 |

## 2. Subsequent valuation

For our example we consider that the Entity sets a useful life for the acquired computer software of 4 years.

Below shows the calculation made to know the **monthly amortisation** of the software acquired:

|  |  |
|--|--|
| Amortisation rate of the period (month): | $\frac{\text{Amortisable basis: €2,500}}{\text{Years of useful life: 4 years}} \times 1/12 \text{ months} = \text{€52.08/month}$ |
|--|--|

Once we know the monthly amortisation expense, we can make the corresponding accounting entry:

| Debit |   |   | Credit   |
|-------|---|---|--|
| 52,08 | (680) Intangible asset amortisation charges |   |  |
|       |   | a | (280) Intangible asset cumulative amortisation 52,08 |

**NOTE:** The amortisation entry should be made monthly until the asset has been fully amortised. In our example there are 48 monthly instalments.

## 3. Permanent loss of value

Now, suppose that after a year, after a visit by the IT technician, they tell us that the software is completely unusable and needs to be replaced.

In this case, the loss our asset suffers is irreversible and the Entity should record an identified impairment against the computer software. The accounting entries would be recorded as follows:

Firstly, the impairment provision charge on the intangible asset:

| Debit |   |          | Credit   |
|-------|---|----------|--|
| 1,875 | (69X) Impairment provision charge on the intangible asset |          |  |
|       |   | <b>a</b> | (29X) Impairment on the intangible asset 1,875 |

Secondly, final derecognition of the asset:

| Debit |  |          |                         | Credit |
|-------|--|----------|-------------------------|--------|
| 625   | (280) Intangible asset cumulative amortisation     |          |                         |        |
| 1,875 | (670) Impairment arising from the intangible asset | <b>a</b> | (206) Computer software | 2,500  |

# Accounting policy manual

## Property, plant and equipment

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Approved by:

SVP Consolidation and Internal  
Control

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## Property, plant and equipment

### 1. Scope

This accounting policy will be applicable to the acquisitions of property, plant and equipment used by the Group for the development of its main activity. Consequently, the acquisition of the following assets falls within the scope of this policy:

- Land and buildings
- Plant and machinery
- Other plant and furniture
- Operational equipment (see section 6.1)
- Other fixed assets

The accounting criteria under this policy are derived from the following international regulation:

| IAS / IFRS | Description                   |
|------------|-------------------------------|
| IAS 16     | Property, plant and equipment |
| IAS 23     | Borrowing costs               |

### 2. Executive Summary

| Area  | Concepts  | Ref.   |
|---|---|--------|
| <b>Initial recognition</b>  |   |        |
| Initial costs   | Property, plant and equipment are recognised at their acquisition cost.   | 3.1    |
| Acquisition cost  | The acquisition cost includes the amount invoiced by the supplier after deducting any discount or reduction in the price, and all additional and directly related expenses which occur until it is put into operation.  | 3.1    |
| Minimum capitalisation amount   | The Group has established a minimum about of €5,000 below which assets should not be capitalised.   | 3.1.1. |
| Concepts included in the acquisition cost recorded as fixed assets                            | Capitalisation costs are those which meet with the definition of an asset.  | 3.1.1. |
| Concepts excluded from acquisition cost which should be recorded as an expense                | The opening and pre-opening costs of a hotel. Advertising, training of staff, rentals paid until opening, etc. will be recorded as an expense for the year in which they are incurred.  | 3.1.2. |
| Property, plant and equipment in progress and transfer to final property, plant and equipment | The construction of buildings, facilities and works carried out in hotels will be recorded in property, plant and equipment accounts in progress until the hotel is opened, at which time they will be transferred to the corresponding property, plant and equipment accounts. | 3.2.   |
| <b>Subsequent recognition</b>   |   |        |
| Useful life   | The Group depreciates property, plant and equipment according to the years of useful life established by the property, plant and equipment item, which must be estimated according to the   | 4.1.1. |

|  |  |        |
|--|--|--------|
|  | economic reality of the asset.   |        |
| Start of depreciation                          | The depreciation start date is the date of completion of the works because it is the date on which the asset is ready to be put into operation. This date is similar to that of the hotel's opening.   | 4.1.2. |
| Calculation of depreciation                    | Depreciation expense is calculated as a result of dividing the depreciable base over its useful life.  | 4.1.3. |
| Depreciation methods                           | The Group has adopted the straight line method. Any other means has to be checked with the Group's Accounting Policy Director.   | 4.1.4. |
| Termination of depreciation                    | This will occur on the date the asset is derecognised or when the asset is fully depreciated.  | 4.1.5. |
| Modification of the useful life estimate       | The useful life will be periodically revised centrally. Any change has to be approved by the Group's Accounting Policy Director.   | 4.1.6. |
| Impairment                                     | See chapter "Impairment on tangible and intangible assets, and goodwill"   | 4.2    |
| Subsequent costs                               | The costs subsequent to initial recognition will be considered maintenance costs except when referring to a renovation which implies an increase in sales or the asset's useful life.  | 4.3.   |
| <b>Derecognitions</b>                          |  |        |
| Derecognitions                                 | The derecognition as a result of their disposal or the cessation of their use will determine the recognition of a result equivalent to the difference between the amount to be received from a third party, and the net book value of the asset. | 5      |
| <b>Other aspects</b>                           |  |        |
| Operational equipment                          | A homogeneous policy to be followed by the group will be established.  | 6.1.   |
| Non-current assets classified as held for sale | When identifying these situations, they should be subject to consultation with the Accounting Policy Director.   | 6.2.   |
| Swaps  | When identifying these situations, they should be subject to consultation with the Accounting Policy Director.   | 6.3.   |
| Revaluations                                   | Revaluations of property, plant and equipment is prohibited by the Group.  | 6.4.   |

### 3. Initial recognition

An element of property, plant and equipment will be recognised as an asset and registered upon receipt, if and only if:

- It is probable that the Group obtains future economic benefits derived from it; and
- The cost of the element can be measured reliably.

### 3.1. Initial costs

The cost of property, plant and equipment includes:

- Its acquisition price: amount invoiced by the supplier after deducting any discount or reduction in price, including import duties and non-recoverable indirect taxes on the acquisition, after deducting any commercial discount or price reduction;
- Any cost directly related to the location of the asset in the place and in the conditions necessary for it to operate in the manner prescribed by management;
- The initial estimate of decommissioning costs (which due to the Group's activity would not be applicable) or withdrawal of the element, as well as the rehabilitation of the place in which it is based, when they constitute obligations incurred by the Group when the element is acquired or as a consequence of using it during a certain period.

#### Accounting Entries

The accounting records to make are:

| Debit  |   | Credit   |
|--|---|--|
| (22X) Property, plant and equipment                  |   |  |
|  | to                                      | Invoices to be received (400)                        |
|  | <i>For the reception of assets</i>      |  |
| (400) Invoices to be received                        |   |  |
|  | to                                      | Suppliers of the property, plant and equipment (412) |
|  | <i>For the reception of the invoice</i> |  |
| (412) Suppliers of the property, plant and equipment |   |  |
|  | to                                      | Treasury (57X)                                       |
|  | <i>For the payment of suppliers</i>     |  |

#### 3.1.1. Capitalisable concepts

Capitalisable concepts are those which fulfil the definition of an asset as detailed in point 3 above.

Grupo NH has set a limit of €5,000 under which no element would be considered capitalisable even when meeting the previous definition.

The activation criteria should be understood at an element level, without taking the volume of elements acquired into account. We refer also to section 4.3.3. of Renovations where it is detailed that an item can be capitalised in the case of substitution, as long as it supposes the derecognition of the associated asset.

Likewise, the following items may be capitalised:

- Financial expenses: as established in IAS 23, the Group will capitalise borrowing costs which are directly attributable to the acquisition, construction or production of qualifying assets as part of the cost of those assets. The Group shall recognise other borrowing costs as an expense in the period in which they are incurred. The Group's policy is not to activate financial expenses, although on those occasions when they may be applicable to any of the Business Units, they must be previously authorised by the Group's Accounting Policy Director.
- Work performed by the company for its fixed assets: in those cases in which this situation occurs, the cost of the tangible fixed asset constructed by the Group is determined on the same principles as if it

were an acquired fixed asset, also considering the criteria established for the cost of production of inventories. The capitalisation of the cost of production is made by means of the payment of the costs attributable to the asset of the item Work carried out by the Group for non-current assets in the profit and loss account. Currently, this item does not apply to the Group's policy and, should this situation occur, it should be previously authorised by the Group's Accounting Policy Director.

### **3.1.2. Non-capitalisable concepts**

Specifically, as established in the standard, the following items will not be considered as capitalisable expenses:

| <b>Concepts</b>  |
|--|
| Costs of introducing an new product or service (including advertising expenses)  |
| Administrative costs and other general indirect costs  |
| Costs associated with the search for new sites for the opening of new hotels   |
| Staff training costs associated with opening hotels  |
| Costs related to the acquisition of assets which have a period of use of less than one year (e.g.: spare parts or decorative materials)  |
| Expenses incurred prior to the opening of a hotel, such as electricity, water, telephone, other supplies, salaries and wages, selection of staff, cleaning, surveillance, security and rent paid to the lessor prior to opening. |
| Upkeep of fixed assets: varnishing of floors, cleaning of windows, technical services, painting, maintenance and other repairs   |
| Office material  |
| Acquisition of assets under €5,000.  |

Therefore, these costs, even though they are incurred prior to the opening of the hotel, will be recorded as expenses of the year without exception.

|   |   |
|---|---|
| <b>Cost of property, plant and equipment:</b>                     | (+) Amount invoiced by the supplier.  |
|   | (+) Amounts invoices by agents involved in the operation.   |
|   | (+) Costs incurred until in working conditions.   |
|   | <ul style="list-style-type: none"> <li>• Insurance of goods and customs tariffs.</li> <li>• Non-recoverable indirect taxes</li> <li>• Expenses in transporting the asset.</li> <li>• Installation and assembly expenses</li> <li>• Costs of conditioning lots.</li> <li>• Financial expenses incurred until commissioning.</li> </ul> |
|   | (+) Internal costs which meet the conditions to be recognised as an asset.  |
| <b>Not included as the cost of property, plant and equipment:</b> | <ul style="list-style-type: none"> <li>• Repair and maintenance costs.</li> <li>• Recoverable indirect costs to the Treasury, as well as any expense accrued subsequent to the commissioning of the asset.</li> <li>• Opening costs.</li> </ul>   |

## 3.2. Property, plant and equipment in progress

The acquisition cost related to the construction of buildings and facilities, acquisitions of furniture or any other type of investment resulting from the opening or renovation of a hotel for its commissioning will be recorded in property, plant and equipment in progress until it is in the expected conditions of use, at which time the transfer to the corresponding property, plant and equipment accounts will occur.

In the case of works carried out in hotels before their opening, the transfer date of property, plant and equipment in progress to final property, plant and equipment takes place on the date the hotel opens.

### Example

The Group is carrying out works to renovate a hotel. The total estimated cost is 260,000 euros. These works will take three months and three invoices will be issued for 50%, 30% and 20% respectively of the total cost.

The accounting entries to make are:

| Account | Description                               | Debit   | Credit |
|---------|---|---------|--------|
| 228     | Property, plant and equipment in progress | 130,000 |        |

|   |   |         |         |
|---|---|---------|---------|
|   | (260,000*50%)   |         |         |
| 412   | Creditors for purchase of property, plant and equipment |         | 130,000 |
| <i>Month 1 - On receipt of the first invoice</i>  |   |         |         |
| 228   | Property, plant and equipment in progress (260,000*30%) | 78,000  |         |
| 412   | Creditors for purchase of property, plant and equipment |         | 78,000  |
| <i>Month 2 - On receipt of the second invoice</i>   |   |         |         |
| 228   | Property, plant and equipment in progress (260,000*20%) | 52,000  |         |
| 412   | Creditors for purchase of property, plant and equipment |         | 52,000  |
| <i>Month 3 - On receipt of the final invoice</i>  |   |         |         |
| 22X   | Buildings   | 200,000 |         |
| 22X   | Facilities and furniture                                | 60,000  |         |
| 228   | Property, plant and equipment in progress               |         | 260,000 |
| <i>Transfer to property, plant and equipment by nature which should be made on the date the hotel opens</i> |   |         |         |
| 412   | Creditors for purchase of property, plant and equipment | 260,000 |         |
| 57X   | Cash  |         | 260,000 |
| <i>Upon payment to the supplier</i>   |   |         |         |

## 4. Subsequent valuation

The subsequent valuation will be based on the net book value of the property, plant and equipment, which is defined as follows:

### Net book value of the property, plant and equipment:

- (+) Initial costs
- (-) Cumulative amortisation/depreciation
- (-) Impairment or loss of value
- (+) Subsequent costs

## 4.1. Depreciation

After initial recognition, the property, plant and equipment will be depreciated along its useful life according to the chosen method. The criteria for estimating depreciation: useful life and depreciation method will be periodically revised by the Group.

The depreciation reflects the ordinary depreciation suffered by the asset as a result of the use of property, plant and equipment in the course of the Group's activities.

### 4.1.1. Useful lives

The useful life is the period during which the asset is expected to be used by the Group. The useful life has to be estimated in accordance with the economic reality of the asset. As a result, to determine the useful life of an asset, the following factors are taken into account:

- a) The forecast use of the asset.
- b) Expected physical wear.
- c) Technical or commercial obsolescence.
- d) Legal limits or similar restrictions (e.g. maturity dates of related lease contracts).

At the time of the depreciation's accounting record, the Group must determine whether the useful life of property, plant and equipment is defined or indefinite. As a general rule, it will consider:

- Property, plant and equipment with an indefinite useful life (land): as a general rule, these elements do not depreciate.
- Property, plant and equipment with a defined useful life: subject to depreciation according to their useful life.

The Group will depreciate its property, plant and equipment in accordance with the estimated years of useful life as detailed in Annex I.

#### 4.1.2. Start of depreciation

The depreciation of an asset will begin when it is available for use, that is, when it is in the location and in the conditions necessary to operate in the manner anticipated by management.

As a general rule, there is a need to register and begin depreciation on their reception; for the depreciation of hotels, its opening date will be that considered. In the case of renovations, in order to determine the depreciation start date, if the works do not involve the closing of the hotel, the date of entry into operation will be the end of the works. Group policy is to start depreciating assets from the first day of the month following their registration.

#### 4.1.3. Calculation of depreciation

Depreciation of property, plant and equipment is calculated by dividing the depreciable base of the asset by its useful life. Depreciable base is understood as the cost of the asset minus its residual value. In addition, the residual value of an asset is the amount that the Group would receive for the asset at the closing date of an accounting period with the age and conditions it would have on the date on which it is sold by the Group.

Based on the Group's experience, the residual value of the various elements which make up property, plant and equipment **will be considered zero** for the purposes of calculating depreciation.

Depreciable base of property, plant and equipment = Cost of property, plant and equipment

The one-month amortisation rate will therefore be calculated as follows:

$$\text{Depreciation rate of the period (month): } \frac{\text{Depreciation base}}{\text{Years of useful life}} \times 1/12 \text{ months}$$

#### 4.1.4. Depreciation methods

The depreciation method used will reflect the pattern under which the future economic benefits of the asset are expected to be consumed by the Group.

International regulations establish that various depreciation methods may be used to systematically distribute the depreciable amount of an asset over its useful life. These methods include the straight line method,

declining balance method, and production units methods. In this sense, the Group has adopted **the straight line application criterion** as is it that which best reflects the economic life of the asset and for its being the most commonly applied method in the industry. The application of this method results in the same annual depreciation expense over the useful life of the asset.

#### Example

On 1 January, the Group acquired computer equipment for one of its hotels with a cost of 1,000 and an estimated useful life of 5 years. The residual value at the end of the year is considered zero. In these circumstances, the application of the straight line method would determine a constant amortisation as shown in the table:

| Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|--------|--------|--------|--------|--------|
| 200    | 200    | 200    | 200    | 200    |

Therefore, the following entry must be made each month to record the depreciation of the corresponding asset:

| Account  | Description   | Debit | Credit |
|--|---|-------|--------|
| 682  | Allocation of depreciation on property, plant and equipment (200/12 months) | 16.67 |        |
| 282  | Cumulative depreciation on property, plant and equipment                    |       | 16.67  |
| <i>Value correction for the depreciation of property, plant and equipment based on the elements useful life.</i> |   |       |        |

Any other depreciation method has to be checked with the Group's Accounting Policy Director.

#### 4.1.5. Termination of depreciation

The termination of depreciation of the different elements which make up the property, plant and equipment must occur on the date on which the asset is derecognised or when it is fully depreciated, or reclassified as assets held for sale (see section 6.1).

The accounting standard establishes that in early termination of depreciation an impairment provision should be made for its full net book value. However, given that the Group's systems do not allow for this operation, in the case of an impairment provision, the monthly depreciation will continue on the straight line and at the end of the year an adjustment will be made to settle the depreciation recorded.

#### 4.1.6. Modification of the useful life estimate

The useful life has to be revised centrally by Grupo NH with the aim of identifying if there are any circumstances which could give rise to changing the initial criteria. Changes in useful life will be communicated by the Group's Accounting Policy Director who will outline the reasons which justified the change and the criteria which should be made by the various Business Units affected. Therefore, the useful life of no element can be changed without prior consultation and express authorisation from the Group's Accounting Policy Director.

In accordance with international regulations, the changes will be adjusted prospectively, that is, without correcting the opening balances of accumulated depreciation, but by modifying the future depreciation expense.

### 4.2. Impairment of Property, plant and equipment

This section is developed in the Chapter "Impairment on tangible and intangible assets, and goodwill".

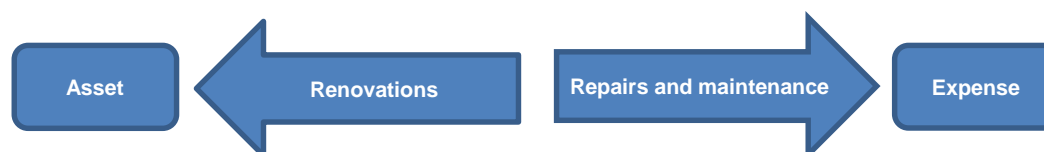


### 4.3. Subsequent costs

#### 4.3.1. General criterion

Expenses incurred subsequent to initial recognition can only be recorded as part of its cost if the general criteria applicable to the initial recognition of an asset are considered to have been met, i.e., if it is probable that they will produce future economic benefits and if the cost of the element can be reliably measured.

As a general criterion, enlargement, modernisation and improvement costs entailing an increase in productivity, capacity or efficiency or a lengthening of the assets' useful life are recognised as increases in the cost of such assets. Conservation and maintenance costs are charged against the profit and loss account for the year in which they are incurred.



#### 4.3.2. Repairs and maintenance

Repair and maintenance expenses must be recorded as such in the profit and loss account for the year in which they were incurred. These expenses are those which allow property, plant and equipment:

- To be returned to conditions of use; or
- To maintain adequate usage conditions, maintaining its productive capacity.

In general, any action taken after the opening or renovation of a hotel will be considered repair or maintenance. In the case of a renovation involving replacement of complete elements, the criteria detailed in the section on renovations will be followed. As an example, expenses which cannot be recorded as property, plant and equipment are:

- Minor masonry repairs.
- Painting of buildings.
- Repair and maintenance of lifts, air-conditioning units, kitchens, other machinery and facilities.
- Minor repair and maintenance works in bedrooms, lounges and common areas.
- Maintenance of gardens, replanting, etc.

#### 4.3.3. Renovations

Actions subsequent to opening which are considered renovations and therefore recognition as assets are as follows:

- Renovations of hotels.
- Expansions through acquisition of local buildings.
- Other minor renovations: this includes other renovations with replacement of complete elements, changes in the configuration of hotels or adaptations to legal regulations (disabled persons law, etc.).

When there is a substantial renovation and/or replacement of property, plant and equipment, the following should occur:

- a) Account for the derecognition of the original item at its net book value, that is, the cost, cumulative depreciation and impairment provision (if any) of the items withdrawn will be derecognised and the counterpart of the item carried to the profit and loss account.
- b) Capitalise, integrating as the greater value of property, plant and equipment, the amount of renovations carried out according to the acquisition price provided that the conditions applicable to the recognition of

the asset are met (probability of generating future economic benefits and reliability in the determination of the cost component) whose depreciation period will commence thereafter.

It should be noted that once it is known that a hotel is subject to renovation, the assets which will be subject to renovation must be depreciated at an accelerated rate up to the date of the renovation.

If the renovation concerns a part of a fixed asset whose book value cannot be clearly identified, the cost of the renovation may be taken as an indication of the cost of the item being replaced; for its calculation, the cost of the asset will have to be deflated, calculating the cumulative depreciation and derecognising the asset by the net amount. If this information is not available, the acquired elements should be registered as an expense.

### Accounting entries

To account for the derecognition of the fixed asset:

| Debit  |    | Credit                              |
|--|----|-------------------------------------|
| (282) Cumulative depreciation on property, plant and equipment |    |                                     |
| (671) Losses from property, plant and equipment                | to | Property, plant and equipment (22x) |

To account for the recognition of the fixed asset:

| Debit                               |    | Credit  |
|-------------------------------------|----|---|
| (22x) Property, plant and equipment |    |   |
|                                     | to | (57X) Treasury/<br>Suppliers of the property, plant and equipment (412) |

## 5. Derecognition of fixed assets

Derecognition of property, plant and equipment may occur for the following reasons:

- Sale of the asset being derecognised
- Renovation (see section 4.3.3 above)
- Hotel closure

The derecognition of the various assets will be made at their net book value. In the case of a derecognition associated with a recognition, it will be calculated as explained in section 4.3.3 above. In those cases in which partial derecognitions are involved, the net book value to be eliminated will be that corresponding to the part subject to disposal alienation or withdrawal. The derecognition of the various assets recorded in the property, plant and equipment accounts will determine the recognition of a result equivalent to the difference between the amount receivable (if any) and the net book value of the asset.

Results arising from the sale: Gain (+) / Loss (-): Sales price - (Cost of asset sold - Cum. Dep. - Provision for impairment loss)

### Accounting entries

- If the sale results in a net loss

| Debit  |    | Credit                              |
|--|----|-------------------------------------|
| (282) Cumulative depreciation on property, plant and equipment         |    |                                     |
| (57X) Treasury or accounts receivable for the sale of the fixed asset. |    |                                     |
| (292) Impairment of property, plant and equipment                      |    |                                     |
| (671) Loss from property, plant and equipment                          | to | Property, plant and equipment (22x) |

- If the sale results in a net gain

| Debit   |    |  | Credit |
|---|----|--|--------|
| (282) Cumulative depreciation on property, plant and equipment        |    |  |        |
| (57x) Treasury or accounts receivable for the sale of the fixed asset |    |  |        |
| (29X) Impairment of property, plant and equipment                     | TO | Property, plant and equipment (22X)          |        |
|   |    | Gains on property, plant and equipment (771) |        |

The date on which the asset is derecognised shall be the date on which the following conditions are met:

- That there is no involvement in the current management of the assets sold, which is normally associated with ownership of them;
- That the risks and benefits have significantly transferred to the purchaser and there is no control over the asset;
- That the amount of ordinary income can be measured reliably;
- That it is probable that the company receives economic benefits associated with the transaction; and
- That the costs incurred, or to incur, in relation to the transaction can be measured reliably.

## 6. Other aspects

### 6.1. Operational equipment

The Group calls equipment to operate the hotel 'operational equipment' including: linens (sheets, tablecloths, towels, etc.), crockery and glassware. These assets have the peculiarity that permanent breakages occur. Given the difficulty of having absolute control of the recognitions and derecognitions, two possible accounting treatments are contemplated:

- Activation at the start**
  - Operational equipment elements would be activated with the opening of the hotel at acquisition cost as explained in section 3 and would subsequently be depreciated on a straight-line basis over their useful life. After the recognition date of the hotel, all purchases must be recorded as an expense for the year in which they are incurred.
  - At the present date it implies the need to evaluate the needs of operational equipment at the hotel and country level and to make an estimate of the cost and accumulated depreciation to date, which means determining the impact and adjustments which could occur in the profit and loss account.
- Activation of all elements**
  - All operational equipment items would be considered fixed assets and would be activated at their acquisition cost upon receipt (see section 3). Subsequently, they will be depreciated following the useful life defined by the Group. This criterion would imply the need to carry out

exhaustive controls and derecognise the elements, by their net book value, associated to the recognitions subsequently produced.

- At the present date it implies the need to make a real inventory and determine the cost and accumulated depreciation of the existing operational equipment.

## **6.2. Non-current assets classified as held for sale**

In those cases in which the net book value of property, plant and equipment is intended to be recovered mainly through a sale transaction and not through continued use, the net book value of the asset will be reclassified to non-current assets held for sale if they meet the following conditions:

- That the asset is available for immediate disposal in the conditions under which it is at that time.
- That the sale is highly probable. This implies that the assets held for sale must therefore meet the following conditions:
  - Its sale must be highly probable, so the Group's Management must be committed to the sales process and it should have started.
  - The sales price should be a market price.
  - It will also be necessary to expect recognition of income to take place within the next 12 months.

When the above requirements are met, the Group's Accounting Policy Management should be informed and, in case of express authorisation:

- Assess the impairment of the element sold or distributed prior to the application of the valuation criteria referred to in this section;
- Classify the asset or group of assets as a non-current asset held for sale on a separate line of the statement of financial position which should form part of current assets;
- Value the asset at the lower of the book value and fair value less costs to sell and
- Halt the asset's depreciation.

Any gain or loss on the sale after its classification will be recorded in the profit and loss account at the time of sale. In the event that the requirements cease to be met, the asset will be reclassified as property, plant and equipment, and valued at the lower of its recoverable amount, or the book value had it not been classified as non-current assets held for sale, that is, considering the corresponding depreciation not applied. Any difference is recorded in profit or loss for the year.

Assets which are to be abandoned or withdrawn for an undefined time will not be classified as non-current assets held for sale but will be subject to the provisions of the section on impairment.

## **6.3. Swaps**

Property, plant and equipment may be acquired in exchange for one or more non-monetary assets, or a combination of monetary and non-monetary assets. The cost of such property, plant and equipment shall be measured at its fair value, unless the exchange transaction is not commercial in nature, or the fair value of the asset received or the asset delivered cannot be measured reliably.

In the case of non-commercial swaps, the cost of the asset received will be valued at the book value of the asset delivered.

The Group will determine whether an exchange is commercial or not, considering the extent to which future cash flows are expected to change as a result of the transaction. A swap will be commercial if: the configuration (risk, schedule and amount) of the cash flows of the asset received differs significantly from the configuration of the cash flows of the transferred asset; or the specific value for the Group of the part of its activities affected by the exchange is significantly changed as a result of the exchange.

## 6.4. Revaluations

The regulation contemplates that if the fair value can be reliably measured, all the elements belonging to the same class of property, plant and equipment can be measured at their revalued amount, which is the fair value at the revaluation date, less any cumulative depreciation or cumulative impairment losses which have subsequently arisen. However, revaluations **are prohibited by the Group**.

## 6.5. Grupo NH Policy

Ultimately, in its activity's ordinary situations, Grupo NH will account for property, plant and equipment as it has been doing, and in exceptional circumstances will require the authorisation of the Group's Accounting Policy Director as detailed below:

| Approval by the Accounting Policy Director                        |
|---|
| Activation of financial expenses.                                 |
| Activation of works carried out on property, plant and equipment. |
| Changes in the estimate of useful life.                           |
| Reclassification to non-current assets held for sale.             |
| Commercial or non-commercial swaps.                               |
| Depreciation methods.   |
| Changing useful lives.  |

And in any event, the following will be prohibited:

| Prohibited  |
|---|
| Activation of expenses below the established minimum. |
| Revaluation of Property, plant and equipment.         |

## 7. Related regulations

1. Operational and financial leases. See module ["Operational and financial leases"](#)
2. Intangible assets. See module ["Intangible assets"](#)
3. Goodwill. See module ["Goodwill"](#)
4. Impairment of Tangible assets. See module ["Impairment on Tangible and Intangible Assets, and Goodwill"](#)

## 8. Practical example

The following example is offered for illustrative effects to show the most frequent accounting entries in the accounts of the module:

### 1. Initial recognition at acquisition or recognition:

Acquisition of an air conditioning system for 9,500 euros; additionally the technician who comes to install said system will charge NH 500 euros for installation and labour. On the day of installation, the technician has a mishap and it is decided that the wall of the plenary room will have to be painted at a cost of 200 euros.

Firstly, it will be necessary to determine the acquisition price of the system:

- Cost price: 9,500 euros
- Labour and installation: 500 euros
- Painting: 200 euros

This way, and following the formula proposed in previous sections, the acquisition price of the system will be:

|   |   |
|---|---|
| <b>Cost of the air conditioning system:</b> | (+) Amount invoiced by the supplier = 9,500 euros |
|   | (+) Costs incurred until in working conditions:   |
|   | • Installation and assembly expenses = 500 euros. |

**TOTAL = 9,500 euros + 500 euros = 10,000 euros.**

Therefore the costs of painting the wall are not included as they are considered an expense for the year.

In our example, we propose two possible situations when making the purchase: a) cash settlement on acquisition; or b) payment for the air conditioning system (technical installation) happens two months after acquisition.

a. Cash settlement:

| Debit  |                               |    |                | Credit |
|--------|-------------------------------|----|----------------|--------|
| 10,000 | (22X) Technical installations |    |                |        |
| 200    | (622) Repair and conservation | to | (57X) Treasury | 10,200 |

b. Payment made after acquisition of the machine (payment for the painting is made on the spot):

b.1. At the time of acquisition:

| Debit  |                               |    |                                    | Credit |
|--------|-------------------------------|----|------------------------------------|--------|
| 10,000 | (22X) Technical installations |    |                                    |        |
| 200    | (622) Repair and conservation | to | (412) Suppliers of the fixed asset | 10,000 |
|        |                               |    | (57X) Treasury                     | 10,200 |

b.2. At the time of payment:

| Debit        |                              |    |                | Credit |
|--------------|------------------------------|----|----------------|--------|
| (412) 10.000 | Suppliers of the fixed asset |    |                |        |
|              |                              | to | (57X) Treasury | 10,000 |

## 2. Subsequent valuation

As explained in previous sections, property, plant and equipment items suffer losses in value and impairments as a result of their use.

For our example we consider that NH sets a useful life for the acquired air conditioning system of 10 years.

Below shows the calculation made to know the **monthly amortisation** of the equipment acquired:

|  |   |   |             |   |              |
|--|---|---|-------------|---|--------------|
| Depreciation rate of the period (month): | $\frac{\text{Amortisable basis: } \text{€10,000}}{\text{Years of useful life: 10 years}}$ | x | 1/12 months | = | €83.33/month |
|--|---|---|-------------|---|--------------|

Once we know the monthly amortisation expense, we can make the corresponding accounting entry:

| Debit |  |    |   | Credit |
|-------|--|----|---|--------|
| 83.33 | (682) Property, plant and equipment depreciation charges |    |   |        |
|       |  | to | (282) Property, plant and equipment cumulative depreciation | 83.33  |

NOTE: The amortisation entry should be made monthly until the asset has been fully amortised.

## 3. Sale of property, plant and equipment:

In this case, we assume that 7 years from the acquisition and installation of the air conditioning system (technical installations), the hotel decides to sell it to a third party. In our example we propose two situations which could occur in the event of sale of the fixed assets: a) the hotel sells the air conditioning system with a gain resulting from the sale or b) of the sale of the air conditioning system resulting in a net loss.

a) If the sale results in a net gain:

In this case, we suppose the hotel sells the air conditioning system for 5,000 euros. We calculate the net gain resulting from the sale of the asset:

1. Sales price: 5,000 euros
2. Cost of the air conditioning system: 10,000 euros
3. Cumulative depreciation on the date of sale (7 years):  $83.33 \times 12 \times 7 = 7,000$  euros.

This way, and following the formula proposed in previous sections:

$$\text{Gain from the sale} = 5,000 \text{ euros} - (10,000 \text{ euros} - 7,000 \text{ euros}) = 2,000 \text{ euros}$$

After calculating the gain obtained by the hotel after the sale of the air conditioning system, the Group will record the following accounting entry:

| Debit  |    | Credit   |
|--|----|--|
| 7,000 (282) Cumulative depreciation on property, plant and equipment |    |  |
| 5,000 (57X) Treasury   |    |  |
|  | to | Technical installations (22X) 10,000               |
|  |    | Gains on property, plant and equipment (771) 2,000 |

b) If the sale results in a net loss:

We suppose the hotel sells the air conditioning system for 1,000 euros. We calculate the net loss resulting from the sale of the asset:

- Sales price: 1,000 euros
- Cost of the air conditioning system: 10,000 euros
- Cumulative depreciation on the date of sale (7 years):  $83.33 \times 12 \times 7 = 7,000$  euros.

**Loss from the sale = 1,000 euros – (10,000 euros – 7,000 euros) = -2,000 euros**

Therefore, the accounting entry which NH records is:

| Debit  |    | Credit                               |
|--|----|--------------------------------------|
| 7,000 (282) Cumulative depreciation on property, plant and equipment |    |                                      |
| 1,000 (57X) Treasury   |    |                                      |
| 2,000 (671) Losses from property, plant and equipment                | to | Technical installations (22X) 10,000 |



# Accounting policy manual

## Impairment of non- current assets

Version date

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Approved by:

SVP Consolidation and  
Internal Control

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## Impairment of non- current assets

### 1. Scope

Aspects considered in this policy will apply to all tangible and intangible assets. Therefore, this policy includes the accounting policies to identify and quantify the impairment on non-current tangible and intangible assets. Aspects analysed in this chapter therefore apply to the following assets:

- Property, plant and equipment
- Intangible asset
- Goodwill

As a result, the impairment on the following will be outside the scope of this chapter: stocks, deferred tax assets, financial assets and non-current assets classified as held for sale.

This accounting policy will apply to all Grupo NH companies. In terms of methodology, the calculation of impairment of assets will be made by NH's Investments Department in conjunction with the Business Units and with the approval of the Accounting Policy Director. Each Business Unit will be responsible for the accounting record of the loss or its reversion as well as the operational assumptions of each hotel used in the projection.

The accounting criteria under this policy are derived from the application of the following international regulation:

| IAS / IFRS | Description                       |
|------------|-----------------------------------|
| IAS 36     | Impairment of non- current assets |

### 2. Executive Summary

| Area                                      | Concepts   | Ref. |
|---|--|------|
| <b>Steps in testing for impairment</b>    |  |      |
| Steps in testing for impairment           | <p>The steps to test for impairment are:</p> <ul style="list-style-type: none"> <li>▪ Identify the level at which the impairment of assets is tested.</li> <li>▪ Determine when to test the impairment.</li> <li>▪ Determine the sequence of impairment tests.</li> <li>▪ Determine the recoverable amount.</li> <li>▪ Determine the book value of the CGU.</li> <li>▪ Value and recognise the impairment loss.</li> </ul> | 3    |
| <b>Identification of impairment level</b> |  |      |
| Individual assets                         | As far as possible the impairment test should be carried out at the level of the individual asset. However, in most cases this is complex as the cash inflows which each asset generates individually cannot be identified.  | 4    |
| Cash Generating Units                     | <p>They are the smallest group of assets which can generate cash inflows, independent of those generated by other assets of groups of assets if any.</p> <p>Grupo NH considers each hotel to be a CGU.</p>   | 4    |

|  |  |      |
|--|--|------|
| Common assets                                      | By definition, an entity's common assets contribute to cash inflows of one or more CGUs without generating their own cash inflows.   | 4    |
| Goodwill   | An asset which does not generate separate cash inflows.  | 4    |
| <b>Determination of the testing date</b>           |  |      |
| Testing date                                       | In Grupo NH, assessment of impairment is made at each year end when there is evidence of impairment and once a year for goodwill.  | 5.1. |
| Indicators of impairment                           | Indicators of impairment are those internal or external indicators on which the value of an asset or CGU may have become impaired.   | 5.2. |
| <b>Determine the sequence of impairment tests.</b> |  |      |
| Sequence of impairment tests.                      | In Grupo NH, as a general rule, the impairment should be tested at a hotel (CGU) level.  | 6    |
| <b>Determine the recoverable amount</b>            |  |      |
| Recoverable value                                  | The recoverable amount of an asset or cash generating unit is the greater between its fair value less costs to sell and its value in use.<br><br>As previously mentioned, in Grupo NH the determination of recoverable value will usually be made through calculating the value in use, although evidence on fair value less costs to sell can be turned to. | 7    |
| Value in use                                       | The value in use of the current value of estimated future cash flows which a cash generating unit (hotel) is expected to obtain.   | 7.1. |
| Fair value less costs to sell                      | The best evidence of the fair value of the asset less costs to sell is the existence of a price, within a formal sales commitment, of a transaction made in mutually independent conditions, adjusted by the incremental costs directly attributable to the disposal or disposition by other means of the asset.   | 7.2. |
| <b>Determine the book value of the CGU</b>         |  |      |
| Book value of a CGU                                | For individual assets, the book value is the net book value directly.<br><br>When dealing with hotels, the book value of a cash generating unit will be the net book value of the assets located in the hotels.  | 8    |
| <b>Record of the loss</b>                          |  |      |
| Record of the loss                                 | The book value of an asset will be reduced to its recoverable amount if this recoverable amount is less than the book value. This reduction is known as the impairment loss. The impairment loss is recognised immediately in the profit/(loss) for the year.  | 9    |

| Reversal of losses |  |    |
|--------------------|--|----|
| Reversal of losses | On each balance sheet date, the Group will assess if there is any indication that an impairment loss recognised in previous years, for an asset other than goodwill, no longer exists or could have decreased. Should such indication exist, the Group will again estimate the asset's recoverable amount. | 10 |

### 3. Steps in testing for impairment

As established in international regulation, the chronological steps to take to test the impairment on an asset are as follows:

- Identify the level at which the impairment of assets is tested.
- Determine when to test the impairment.
- Determine the sequence of impairment tests.
- Determine the recoverable amount.
- Determine the book value of the CGU.
- Value and recognise the impairment loss.

Each of these steps are described in the following sections of this policy as well as the casuistry of Grupo NH, distinguishing the aspects related to the impairment according to the types of asset in question.

### 4. Identification of impairment level

The impairment of the assets which fall under the scope of this standard correspond to different levels which are described below:

- Individual assets: as far as possible the impairment test should be carried out at the level of the individual asset. However, in most cases this is complex as the cash inflows which each asset generates individually cannot be identified.
- Cash Generating Units (CGU): they are the smallest group of assets which can generate cash inflows, independent of those generated by other assets or groups of assets if any. Two basic aspects must be considered in the determination of CGUs:
  - Separation of ordinary income: to determine if the income streams generated by said group of assets are independent of each other.
  - Separation of assets: it must be determined if the assets which form part of the group of assets can be separated from the different income streams they generate.

The Group has defined cash generating units as:

- Hotels
- Restaurants whose operation is independent of other CGUs such as the Casino de Madrid
- Spas whose operation is independent of other CGUs such as the Spa Eurobuilding
- Other cost centres whose operation is independent of other CGUs such as the Baluarte conference centre or the NH Campus.

Central services and similar are not considered cash generating units.

- Common assets: by definition, an entity's common assets contribute to cash inflows of one or more CGUs without generating their own cash inflows. An example of this could be the Group's head office or central services.

Since the entity's common assets do not generate cash inflows separately, the recoverable amount of an common asset considered individually cannot be calculated unless management has decided to dispose of it. As a result of this, if there were any indication that a common asset may be impaired, the recoverable amount will be determined for the cash generating unit, or group of generating units, to which that common asset belongs and compared with the book value which corresponds to the unit or groups of units.

- Goodwill: an asset which does not generate separate cash inflows (see capital "Business combinations and goodwill").

## **5. Determine when to test the impairment**

### **5.1. Determine when to test the impairment**

Depending on the type of asset or group of assets on which a deterioration test is to be carried out, the regulations establish the frequency with which such tests must be carried out. Specifically, the impairment assessment must be carried out:

- On the filing date of financial information for each asset or CGU when there are indicators of impairment.
- At least once per year for certain assets regardless of whether or not there are indicators of impairment. These assets are goodwill, intangible assets with undefined life and intangible assets in progress.

The annual assessment referred to in the previous paragraph should be made in addition to the assessment derived from the presence of impairment indicators.

In Grupo NH, assessment of impairment is made at each year end when there is evidence of impairment and once a year for goodwill.

### **5.2. Indicators of impairment**

Indicators of impairment are those internal or external indicators on which the value of an asset or CGU may have become impaired.

#### **5.2.1. Indicators of impairment of a hotel**

In assessing whether there is any indication that the value of the asset may have impaired, the Group has defined the following indicators:

- Payback period: Given that after opening a hotel or restaurant a minimum time in operation is required to achieve normal income, those CGUs which have exceeded their payback period, which has been set at 3 years, will be analysed.
- Operations system: The operations system of the CGU will be identified since those operated under ownership or lease may deteriorate while those operated through a management contract should not have capitalisable costs and, in principle, should only generate income
- Operating losses of more than 150 thousand euros.

- Impairment identified in previous years.
- Hotels in which a decision to close has been taken, regardless of whether the other criteria are met.

### **5.2.2. Indicators of impairment for other assets**

In the case of individual or common assets, the Group has not defined standard indicators on the basis of which to determine whether an impairment analysis is necessary.

However, at the end of each period, the existence of any internal or external evidence which may lead to the need for further analysis will be analysed, such as the following:

#### **External sources of information**

- During the year, the market value of the asset has decreased significantly more than would be expected as a result of the passage of time or its normal use.
- During the year, significant changes with an adverse impact which have taken place or will take place in the immediate future, referring to the legal, economic, technological or market environment in which it operates, or in the market to which the asset is destined.
- During the year, market interest rates, or other investment return market rates, have undergone increases which are likely to affect the discount rate used to calculate the value in use of the asset, so as to significantly decrease its recoverable amount.
- The book value of the net assets is greater than their market capitalisation.

#### **Internal sources of information**

- Evidence is available on the obsolescence or physical impairment of an asset.
- During the year, significant changes have taken place or are expected to take place in the immediate future in the scope or manner in which the asset is used or expected to be used which would adversely affect Grupo NH. These changes include the asset being idle, plans to discontinue or restructure the activity to which the asset belongs, plans to dispose of the asset before the expected date, and reconsideration of the useful life of an asset previously considered undefined as finite.
- There is evidence from internal reports which indicate that the economic yield of the asset is, or is going to be, worse than expected.

## **6. Determine the sequence of impairment tests.**

In Grupo NH, as a general rule, the impairment should be tested at a hotel (CGU) level. However, the sequence of impairment tests is complicated when there are common assets in the Group or goodwill relating to more than one CGU.

### **6.1. Common assets**

In the case of common assets, the standard establishes two options for verifying impairment. The first would be to assign the cost of the common assets to each of the CGUs based on a consistent criterion and the second, if the former is not possible, to initially assess the CGUs without considering the aforementioned assets and calculate its impairment, and then the minimum number of CGUs to which the aforementioned asset can be assigned will be assessed on a consistent basis, based on the flows of these minimum CGUs, to analyse the recoverability of the assets as a whole (assets assigned to CGUs plus the common asset).

#### *Example*

Suppose that all hotels in a country were subject to impairment which would be an indicator of impairment for the common assets of those hotels. In that case, we would first try to spread the cost of the common assets among the different CGUs based on the sales of each, for example, to determine which part of these would be recoverable. As this first option is complex, we would calculate the impairment at the higher level (hotels-

country) taking the flows derived from the group of CGUs and the total assets into account, i.e. the assets from the CGUs plus the common assets.

## **6.2. Goodwill**

Impairment on goodwill is always be analysed annually.

If the goodwill is assigned to a set of CGUs, each CGU will initially be assessed independently without considering the goodwill and then for the whole including it, as described in the previous paragraph for common assets .

## **7. Determine the recoverable amount**

The recoverable value of the hotels in which impairment indicators have been identified is calculated centrally by NH's Investment Analysis department in coordination with the Business Units which are responsible for the operating assumptions used.

The impairment assessment is designed to determine whether the recoverable amount of an asset or cash generating unit is greater than the book value of the asset or CGU. Otherwise, the loss must be recorded.

The recoverable amount of an asset or cash generating unit is the greater between its fair value less costs to sell and its value in use. It will not be necessary in all cases to calculate both values; given that one of them is higher it will not be necessary to continue with the analysis.

In the event that the fair value less costs to sell an asset or CGU cannot be calculated reliably, for example in the absence of organised markets for such asset or CGU, the value in use will be the basis for determining the recoverable value . This is the case for the Group's hotels. Management has selected the calculation of the value in use of the CGUs as the methodology to determine the recoverable amount, and for this it estimates the current value.

### **7.1. Value in use**

The value in use of the current value of estimated future cash flows which an asset or cash generating unit is expected to obtain.

The methodology and assumptions used by the Group are:

#### **1. Make up of estimates of future cash flows**

Estimates of future cash flows will include:

- a) projections of cash inflows arising from the continued use of the asset;
- b) projections of cash outflows which are required to generate cash inflows for continued use of the asset (including, where applicable, payments which are necessary to prepare the asset for use), and which can be directly attributed, or distributed on a reasonable and uniform basis, to such asset; and
- c) the net cash flows which would, if any, be received (or paid) for the disposal or disposition of the asset at the end of its useful life.

Estimates of future cash flows will not include:

- a) cash inflows or outflows for financing activities; nor
- b) collections or payments for tax on profits.



Based on the above, estimates of cash flows will be made based on the **profit and loss accounts of the CGUs** up to the EBIT line (discounting the internal management fee), adjusting the amount of depreciation and including the maintenance capex (see section 6).

The future cash flows will be estimated in the currency in which they are to be generated and updated using the appropriate discount rate for that currency. NH will convert the actual value applying the exchange rate on the date of the value in use calculation.

Finally, a residual value obtained as perpetual rent in the case of owned assets is added to the projected cash flows (five years), in the case of leased assets it would be the duration of the contract plus unilateral extensions to NH.

## **2. Number of years**

The projections have generally been drawn up over a period of **five years** (except where the remaining term of a lease agreement is shorter).

Cash flow projections after the covered period will be based on previous projections using a growth rate.

The number of years for which expected cash flows will be calculated depends on the operations system:

- a) **Leased hotels:** expected cash flows will be calculated on the remainder of the **contract's duration**, however, for those contracts which consider the possibility of being extended, whenever NH can do so unilaterally and has the intention to continue operating these hotels, the **extensions** can be considered.
- b) **Owned hotels:** expected cash flows will be calculated **in perpetuity**.

## **3. Discount rate**

The discount rate to be used will be an after-tax rate which reflects current corresponding market assessments:

- the time value of the money; and
- the specific risks of the asset for which the future cash flow estimations have not been adjusted.
- This discount rate will be estimated from the weighted average cost of capital.

The Group calculates the discount rate based on the Group's listed price and level of debt. A centrally calculated country rate is used.

## **4. Internal royalty management**

NH Hoteles, S.A. and the local *Headquarters* invoice the hotels a royalty in concept of administration services. However, in remuneration for these services there is generally a transfer of benefits to the parent company, so NH must estimate the overall cost of running a hotel a third party would have.

## **5. "Time period" coefficient**

When calculating the present value of discounted cash flows, a **correction coefficient of 0.5** is applied in the formula since they are not obtained at year-end but throughout the year.

## **6. Maintenance capex**

Estimates of future cash flows should include the hotel maintenance capex since it is a cash outflow which is not considered in the profit and loss account as they are capitalisable costs.

## **7. Purchase option**

In lease contracts which include a **purchase option** in favour of NH, its value **may be added to the value in use** of the CGU since it is a right susceptible to valuation intrinsic to the hotel's operation.

## **8. Historical information and operational assumptions**

The information of the item should be the forecast at the end of the year in which the test is performed and must be presented together with the information from the previous five years since the projections must be based on past history.

The projections also have to be consistent with external information (economic data and from the sector in particular).

If there is a change in trend compared to the past or very significant year-on-year increases in occupancy rates and average prices then they must be justified.

At the end of the year, it should be verified that there are no significant deviations between the item's expected and actual data and estimates for the first projected year and the budgets approved by the NH Management.

### **7.2. Fair value less costs to sell**

The best evidence of the fair value of the asset less costs to sell is the existence of a price, in the case of a firm purchase offer, of a transaction made in mutually independent conditions, adjusted by the incremental costs directly attributable to the disposal or disposition by other means of the asset.

If there is no formal commitment to sell but the asset is traded in an active market, the fair value of the asset less costs to sell would be the market price of the asset, less the costs of disposal or disposition by other means. The appropriate market price will normally be the current buyer price. Where no current buyer price is available, the most recent transaction price may provide the appropriate basis for estimating the fair value of the asset less costs to sell, provided there have been no significant changes in economic circumstances between the date of the transaction and the date on which the estimate is made.

If there is neither a firm sales agreement nor an active market, the fair value less costs to sell will be calculated from the best information available to reflect the amount the Group could obtain, at the balance sheet date, in a transaction under mutually independent conditions between interested and duly informed parties, after deducting the costs of disposal or disposition by other means. To determine this amount, the Group will consider the result of recent transactions with similar assets in the same industrial sector. The fair value of the asset less costs to sell will not reflect a forced sale, unless the management is forced to sell immediately.

Costs of disposal or disposition by other means, other than those already recognised as liabilities will be deducted when calculating fair value less costs to sell. Examples of these costs are legal costs, stamp duties and other similar transaction taxes, the costs of dismantling or moving the asset, as well as all other incremental costs to leave the asset in a condition to be sold. However, severance indemnities and other costs associated with the downsizing or reorganisation of a business, which entail the disposal or disposition by another means of an asset, are not incremental costs directly related and attributable to the disposal or disposition by another means.

In the case of the NH Group, and as mentioned above, the determination of the recoverable value will usually be made by calculating the value in use, given that the fair value less costs to sell cannot be reliably estimated, although there is the option of supporting the conclusion about the impairment in appraisals or purchase offers.

## **8. Determine the book value of the CGU**

For individual assets, the book value is the net book value directly.

When dealing with hotels, the book value of a cash generating unit will be the net book value of the assets located in the hotels (tangible and intangible).

Therefore, the book value of the CGU:

- will include the book value of only those assets which can be directly attributed or distributed according to a reasonable and uniform criterion to the cash generating unit and which will generate the future cash inflows used in determining the value of use of said unit; and
- will not include the book value of any recognised liability (except for deferred tax liabilities), unless the recoverable amount of the cash generating unit cannot be determined without taking account of such liability.

This is because the fair value less costs to sell and the value in use of a cash generating unit are determined excluding cash flows related to assets which are not part of the unit, and liabilities which have already been accounted for.

It may be necessary to consider some recognised liabilities to determine the recoverable amount of the cash generating unit. This could happen if the disposal or disposition by another means of said unit, obliges the buyer to assume a liability. In this case, the fair value less costs to sell (or the estimated cash flow from the disposal or disposition by other means, at the end of its useful life) of the cash generating unit will be the estimated selling price of the assets of the cash generating unit and liabilities, jointly, less the costs corresponding to the disposal or disposal by other means. In order to carry out an appropriate comparison between the book value of the cash generating unit and its recoverable amount, it is necessary to deduct the book value of the liability when calculating both the value in use of the unit and its book value.

## 9. Record of the loss

The book value of an asset will be reduced to its recoverable amount if this recoverable amount is less than the book value. This reduction is known as the impairment loss. The impairment loss is recognised immediately in the profit/(loss) for the year.

When the estimated amount of an impairment loss is greater than the book value of the asset to which it relates, the Group will recognise a liability only if it is required to do so by another standard. By way of example, payment obligations which might arise from early abandonment of a leased premises could be mentioned but future operating losses would never be subject to provisions, except where the operation of the asset is through a lease or similar (see "Onerous contracts" in the chapter ["Provisions, assets and contingent liabilities"](#)).

Upon recognition of an impairment loss, asset amortisation charges will be adjusted in future years in order to distribute the revised book value of the asset less its eventual residual value in a systematic manner throughout its remaining useful life, as described in the Property, Plant and Equipment policy.

As in the case of an individual asset, an impairment loss will be recognised with CGUs if its recoverable amount is less than the book value of the assets which make up the CGU, with the particularity that the impairment loss will be distributed in the following order:

- first, the book value of any goodwill allocated to the cash generating unit (or group of units) will be reduced; and
- then with the other assets of the unit (or group of units), apportioning them according to the book value of each of the assets of the unit (or group of units).

### *Example*

As an example, the Group's Accounting Policy Director has estimated a recoverable value for one of the Group's hotels of 100,000 currency units. The net book value of the hotel amounts to 300,000 currency units.

- Net book value: 300,000 monetary units.
- Recoverable value: 100,000 monetary units.
- Impairment loss: 300,000 monetary units - 100,000 monetary units = 200,000 monetary units

To account for the impairment loss.

| Debit                                  | Credit                                 |
|--|--|
| 200,000 (69X) Provision for impairment |  |
|  | (29X) Provision for impairment 200,000 |

## 10. Reversal of impairment losses

On each balance sheet date, the Group will assess if there is any indication that an impairment loss recognised in previous years, for an asset other than goodwill, no longer exists or could have decreased. Should such indication exist, the Group will again estimate the asset's recoverable amount.

In assessing whether there are indications that the impairment loss recognised in prior years for an asset other than goodwill no longer exists or could have decreased in amount, the Group will consider at least the following indications:

### External sources of information

- During the year, the market value of the asset has increased significantly.
- During the year, significant changes with a favourable effect for the Group have taken place or will take place in the immediate future, referring to the legal, economic, technological or market environment in which it operates, or in the market to which the asset in question is destined.
- During the year, market interest rates, or other investment return market rates, have experienced decreases which are likely to affect the discount rate used to calculate the value in use of the asset so its recoverable amount has increased significantly.

### Internal sources of information

- During the year, significant changes have taken place or are expected to take place in the immediate future in the scope or manner in which the asset is used or expected to be used with a favourable effect for the Group. These changes include the costs incurred during the year to improve or develop the asset's yield or to restructure the activity to which the asset belongs.
- There is evidence from internal reports which indicate that the economic yield of the asset is, or is going to be, better than expected.

When making the reversal, it must be taken into account that the book value of an asset, other than goodwill, increased after the reversal of an impairment loss, will not exceed the book value which could have been obtained (net of amortisation) if an impairment loss had not been recognised for the asset in prior years.

The reversal of an impairment loss on an asset, other than goodwill, will be recognised in profit or loss of the year. Any reversal of the impairment loss on a previously revalued asset will be treated as an increase for revaluation in accordance with that other Standard.

After recognising a reversal of impairment loss, asset amortisation charges will be adjusted for future years in order to distribute the revised book value of the asset less its eventual residual value in a systematic manner throughout its remaining useful life.

As for the reversal of Cash Generating Units, this will be distributed among the assets of that unit, except goodwill, by apportioning the amount based on the book value of such assets. Such increases in the book value will be treated as reversals of impairment losses for the individual assets.

When distributing the reversal of an impairment loss for a cash generating unit, the book value of each asset should not be increased above the lower of:

- Its recoverable amount (if it can be determined)
- The book value (net of amortisation or depreciation) which would have been determined had the impairment loss not been recognised in the previous years.

The amount of the reversal for impairment loss which cannot be distributed to the assets according to the above criteria shall be apportioned among the other assets which make up the unit, except goodwill.

In any case, the reversal of losses has to be expressly approved by the Group's Accounting Policy Director.

## Example

As an example, the Group has estimated that the recoverable value of the previously impaired hotel now amounts to 400,000 currency units. At present, the net book value of the hotel amounts to 100,000 monetary units after the provision of the impairment loss of 200,000 currency units; but because that situation has changed and the recoverable value now rises to 400,000 monetary units, it is possible to reverse the net loss and increase the net book value up to 300,000 monetary units.

- Net book value (before reversal): 100,000 monetary units.
- Recoverable value: 400,000 monetary units.
- Impairment loss in prior years: 200,000 monetary units.
- Reversal of impairment: 200,000 monetary units (*Limit of recoverable value before impairment provision*)

| Debit                                  | Credit                                   |
|--|--|
| 200,000 (29x) Provision for impairment |  |
|  | Reversal for impairment<br>(79X) 200,000 |

## 11. Other related standards

1. Property, plant and equipment See module ["Property, plant and equipment"](#)
2. Intangible assets. See module ["Intangible assets"](#)
3. Goodwill. See module ["Business combinations and goodwill"](#)
4. Onerous contracts. See module ["Provisions, contingent assets and liabilities"](#)

# Accounting policy manual

## Financial instruments

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Approved by:

SVP Consolidation and Internal  
Control

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## Financial instruments

### 1. Scope

This accounting policy applies to a financial instrument, being understood as any contract which simultaneously gives rise to a financial asset in one entity and a financial liability or equity instrument in another entity.

Financial instruments include a wide range of financial assets and liabilities such as:

- **Financial assets:**

- Cash and cash equivalents
- Accounts receivable: customers and sundry debtors
- Credits to third parties, such as loans and financial credits granted, arising from the sale of non- current assets
- Debt securities of other companies acquired: such as obligations, bonds and promissory notes
- Equity instruments of other companies acquired: shares, shareholdings in collective investment institutions and other equity instruments.
- Derivatives with a favourable valuation for the company: amongst these are futures, options, swaps and forward foreign currency trading, and
- Other financial assets such as deposits constituted, dividends receivable and disbursements required on own equity instruments

- **Financial liabilities:**

- Accounts payable: suppliers and sundry creditors
- Bank borrowings
- Obligations or other marketable securities issued such as bonds and promissory notes
- Derivatives with an unfavourable valuation for the company: amongst these are futures, options, swaps and forward foreign currency trading



- Debts with special characteristics
- Other financial liabilities: debts with third parties such as loans and financial credits received from persons or companies which are not credit institutions included with or arising from the purchase of non-current assets, sureties, deposits received and disbursements not required by third parties on shareholdings

The accounting criteria under this policy are derived from the application of the following international regulation:

| IAS / IFRS | Description  |
|------------|--|
| IAS 28     | Investments in associates and joint ventures       |
| IFRS 13    | Fair value measurement                             |
| IFRS 9     | Financial instruments                              |
| IAS 39     | Financial instruments: recognition and measurement |

Items excluded from the scope of this chapter:

- Own shares held (see chapter "Own shares held")
- Financial instruments, contracts and obligations derived from share-based payment transactions (see chapter "Share-based payments")
- Rights and obligations derived from leases (see chapter "Leases")

## 2. Executive Summary

| Area   | Concepts   | Ref. |
|--|--|------|
| <b>Classification and valuation</b>  |  |      |
| Classification   | An instrument or its components are classified at the time of initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the economic basis of the contractual agreement and with the definitions of a financial liability, financial asset and equity instrument.   | 3.1. |
| Definition   | A financial instrument is a contract which gives rise to a financial asset in one company and, simultaneously, a financial liability or equity instrument in another company.  | 3.2. |
| Initial valuation  | A financial instrument is initially valued at its fair value plus the transaction costs directly attributable to the acquisition or issue of the financial asset.  | 3.3. |
| <b>Loans and receivables</b>   |  |      |
| Definition   | They are non-derivative financial assets with fixed or determinable payments which are not traded on an active market, other than: <ul style="list-style-type: none"> <li>- Those where the entity has the intention to sell immediately or in the near future</li> <li>- Those where, since the time of initial recognition, the entity has designated them to be accounted for at fair value with changes in profit and loss or as available for sale</li> </ul> | 4.1. |
| Subsequent valuation   | They are valued at their amortised cost using the effective interest rate method.  | 4.2. |
| <b>Financial instruments at fair value with changes in profit and loss</b> |  |      |
| Definition   | Any asset or liability which is acquired or incurred to generate short-term profits or is part of a portfolio of financial instruments managed for that purpose.   | 5.1. |

|  |   |       |
|--|---|-------|
| Subsequent valuation                         | They are valued at fair value, recording the result of changes in said fair value in the profit and loss account.   | 5.2.  |
| <b>Available-for-sale financial assets</b>   |   |       |
| Definition                                   | Available-for-sale financial assets are those securities which have not been acquired for trading purposes, nor are they classified as held-to-maturity investments.  | 6.1.  |
| Subsequent valuation                         | They are measured at fair value and the gains and losses arising from changes in fair value are recognised in equity until the asset is disposed of or has suffered a stable or permanent impairment, at which time the cumulative gains or losses previously recognised in equity are recognised in the net profit or loss for the year.   | 6.2.  |
| <b>Investments held to maturity</b>          |   |       |
| Definition                                   | They are non-derivative financial assets with a fixed maturity date, whose payments are a fixed or determinable amount, and where the entity has the effective intention and the ability to hold until maturity, other than: <ul style="list-style-type: none"> <li>- Those which the entity has designated them to be accounted for at fair value with changes in profit and loss at the time of initial recognition.</li> <li>- Those where the entity has designated them as assets available for sale; and</li> <li>- Those which fulfil the definition of loans and receivables</li> </ul> | 7.1.  |
| Subsequent valuation                         | They are valued at their amortised cost using the effective interest rate method.   | 7.2.  |
| <b>Shareholdings in associated companies</b> |   |       |
| Definition                                   | A shareholding in an associate company An associate is a company on which the parent company exerts significant influence, understood as the power to intervene in the entity's financial policy and operational decisions.   | 8.1.  |
| Application of the equity method             | Investments in companies over which significant influence is exerted or which are jointly controlled are accounted for using the equity method.   | 8.2.  |
| <b>Other financial liabilities</b>           |   |       |
| Definition                                   | This category is residual. All liabilities are within this category apart from liabilities for trading, liabilities designated at fair value with changes in profit and loss and derivatives which are hedging instruments.   | 9.1.  |
| Subsequent valuation                         | Subsequent to initial recognition, financial liabilities are valued at their amortised cost, calculated using the effective interest rate method.   | 9.2.  |
| <b>Obligations and convertible bonds</b>     |   |       |
| Definition                                   | A bond or instrument which is convertible will give rise to a financial liability (a contractual arrangement to deliver a financial liability (a contractual agreement to deliver cash or another financial asset) and an equity instrument (a call option which grants the holder, for a certain period, the right to convert it into a fixed number of ordinary shares in the entity).  | 10.1. |
| Registration and valuation                   | The issuer of a convertible obligation into shares will first determine the book value of the liability component using the fair value of a similar liability which does not involve an equity component (but   | 10.2. |

|                            |  |       |
|----------------------------|--|-------|
|                            | <p>which does include, where applicable, any non-equity embedded derivatives). The book value of the equity instrument represented by the option to convert the instrument into ordinary shares will be determined by deducting the fair value of the financial liability from the fair value of the composite financial instrument considered as a whole.</p> <p>When converting the convertible instrument at the time of maturity, the entity will write off the liability component and recognise it as equity. The original equity component will remain as such (albeit transferred from one equity item to another). The conversion at maturity does not produce any gain or loss.</p>  |       |
| <b>Derivatives</b>         |  |       |
| Definition                 | <p>A derivative is a financial instrument:</p> <ul style="list-style-type: none"> <li>- Whose value changes in response to the changes of a variable named "underlying"</li> <li>- Which, from the outset, requires a very small or zero net investment with respect to other types of contract which include a similar response to changes in market conditions</li> <li>- Which will be settled on a future date</li> </ul> <p>The Group is exposed to hedging derivatives; mainly exchange rates and interest rates.</p>  | 11.1. |
| Registration and valuation | <p>Derivatives are valued at their market value on their contracted date and subsequent changes are recorded as follows:</p> <ul style="list-style-type: none"> <li>- For fair value hedges, the differences produced in both the hedging elements as well as in the hedged elements (regarding the kind of risk hedged) are directly recognised in the profit and loss for the year.</li> <li>- For cash flow hedges, valuation differences in the effective part of the hedge elements are temporarily recognised in the equity item "Equity valuation adjustments" and not recognised as results or until the hedged element matures. The ineffective part of the hedge is directly entered into the consolidated comprehensive profit and loss statement.</li> </ul> | 11.4. |
| <b>Fair value</b>          |  |       |
| Fair value                 | Fair value is the price which would be received for selling an asset or paid for transferring a liability in an orderly transaction between market participants at the measurement date.   | 12    |
| <b>Amortised cost</b>      |  |       |
| Amortised cost             | The amortised cost of a financial instrument is the amount at which a financial asset or a financial liability was initially valued, minus repayments of principal which have occurred, plus or minus, as the case may be, the part allocated to the profit and loss account using the effective interest rate method, of the difference between the initial amount and the amount of repayments at maturity, and for the case of financial assets, minus any impairment losses which would have been recognised.  | 13    |

### 3. Classification and valuation

#### 3.1. Classification

An instrument or its components are classified at the time of initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the economic basis of the contractual agreement and with the definitions of a financial liability, financial asset and equity instrument.

The classification of financial instruments dictates how these assets and liabilities are subsequently valued in the financial statements. The categories into which all financial assets and liabilities are classified in IAS 39 are as follows:

- Categories of financial assets:
  - Loans and receivables
  - Available-for-sale financial assets
  - Financial assets at fair value with changes in profit and loss
  - Investments held to maturity
- Categories of financial liabilities:
  - Debts and accounts payable
  - Financial liabilities at fair value with changes in profit and loss
  - Other financial liabilities

### 3.2. Definition

A financial instrument is a contract which gives rise to a financial asset in one company and, simultaneously, a financial liability or equity instrument in another company.

A financial instrument is an asset which is:

- Cash
- a contractual right:
  - To receive cash or another financial asset from another entity; or
  - to exchange financial assets or financial liabilities with another entity under potentially favourable conditions for the entity.
- an equity instrument of another company; or
- a contract which is or which may be settled using the entity's own equity instruments

Regardless of their probable future, expected but not promised future transactions are not financial assets nor liabilities since they do not represent situations in which the entity has become party to a contract which requires the delivery or receipt of assets in the future.

### 3.3. Initial valuation

A financial instrument is initially valued at its fair value plus the transaction costs directly attributable to the acquisition or issue of the financial asset.

The fair value of a financial instrument, at the time of initial recognition, is normally the transaction price (i.e. the fair value of the consideration paid or received). If an entity determines that the fair value differs from the transaction price at the time of initial recognition, the entity will account for that instrument on that date in the following manner:

- If the fair value is expressed by a listed price in an active market for an identical asset or liability or is based on a valuation technique using only observable market data, the Group will recognise the difference between the fair value at the time of initial recognition and the transaction price as a gain or loss.

- In all other cases, after initial recognition, the Group will recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor (including time) which market participants would take into account when setting the price of the asset or liability.

Transaction costs are those directly attributable to the acquisition of the financial asset or issuance of the financial liability.

In the case of financial assets, the transaction costs are added to the initially recognised amount, whereas in the case of financial liabilities these costs reduce the initially recognised amount.

Transaction costs of financial instruments at fair value with changes in profit and loss are recognised immediately in profit and loss.



### 3.4. Subsequent valuation

The subsequent valuation of the different categories of financial instruments are detailed in the following sections.

## 4. Loans and receivables

### 4.1. Definition

They are non-derivative financial assets with fixed or determinable payments which are not traded on an active market, other than:

- Those where the entity has the intention to sell immediately or in the near future
- Those where, since the time of initial recognition, the entity has designated them to be accounted for at fair value with changes in profit and loss or as available for sale

Loans originating from the entity itself and those acquired from third parties are included in this category when, at the time of initial recognition, they are not designated as available for sale.

### 4.2. Valuation subsequent to initial recognition

They are valued at their amortised cost using the effective interest rate method (see section 14).

Short-term receivables with no established interest rate can be valued at the original amount of the invoice, unless the effect of allocating interest could be significant.

## 5. Financial instruments at fair value with changes in profit and loss

### 5.1. Definition

Any asset or liability which is acquired or incurred to generate short-term profits or is part of a portfolio of financial instruments managed for that purpose. It will be determined through fulfilment of any of the following requirements:

- It originates from or was acquired for the purpose of selling it in the short term.

- Forms part of a portfolio of financial instruments identified and managed jointly with the aim of earning a profit in the short term.
- Derivative instruments which are not financial guarantee contracts and are not designated as hedging instruments.

## 5.2. Subsequent valuation

They are valued at fair value, recording the result of changes in said fair value in the profit and loss account.

### Items

- If fair value increases:

The financial asset will be increased by crediting account 763 "Gains on fair value measurement of financial instruments":

| Debit           |    | Credit   |
|-----------------|----|--|
| Financial asset | to | (763) Gains on fair value measurement of financial instruments |

- If fair value decreases:

The financial asset will be decreased by charging account 663 "Losses on fair value measurement of financial instruments":

| Debit   |    | Credit          |
|---|----|-----------------|
| (663) Losses on fair value measurement of financial instruments | to | Financial asset |

## 6. Available-for-sale financial assets

### 6.1. Definition

Available-for-sale financial assets are those securities which have not been acquired for trading purposes, nor are they classified as held-to-maturity investments.

### 6.2. Subsequent valuation

They are measured at fair value and the gains and losses arising from changes in fair value are recognised in equity until the asset is disposed of or has suffered a stable or permanent impairment, at which time the cumulative gains or losses previously recognised in equity are recognised in the net profit or loss for the year. At the end of each year, through an "Impairment test", the Group must estimate the possible existence of impairment losses which reduce the recoverable amount of these assets to an amount lower than their book value. The recoverable amount is the greater amount between the fair value less costs to sell or the value in use.

### Items

- If fair value increases:

During the year, increases in fair value will increase the financial asset with a credit to account 900 "Gains on available-for-sale financial assets"

| Debit           |    | Credit   |
|-----------------|----|--|
| Financial asset | to | (900) Gains on available-for-sale financial assets |

- If fair value increases:

During the year, decreases in fair value will decrease the financial asset with a charge to account 800 "Losses on available-for-sale financial assets"

| Debit   |    | Credit          |
|---|----|-----------------|
| (800) Losses on available-for-sale financial assets | to | Financial asset |

At year-end, account 800 "Losses on available-for-sale financial assets" and 900 "Profits on available-for-sale financial assets" will be cancelled at year-end against account 133 "Valuation adjustments to available-for-sale financial assets"

| Debit  |    | Credit  |
|--|----|---|
| (133) Valuation adjustments to available-for-sale financial assets | to | (800) Losses on available-for-sale financial assets |

| Debit  |    | Credit   |
|--|----|--|
| (900) Gains on available-for-sale financial assets | to | (133) Valuation adjustments to available-for-sale financial assets |

## 7. Investments held to maturity

### 7.1. Definition

They are non-derivative financial assets with a fixed maturity date, whose payments are a fixed or determinable amount, and where the entity has the effective intention and the ability to hold until maturity, other than:

- Those which the entity has designated them to be accounted for at fair value with changes in profit and loss at the time of initial recognition.
- Those where the entity has designated them as assets available for sale; and
- Those which fulfil the definition of loans and receivables

Amongst the types of instruments defined as such are the following:

- A debt security with a fixed maturity, at a fixed or variable interest rate
- A debt security with a fixed maturity, even where there is a high risk of default, assuming that the contractual payments of the security are fixed or determinable and they comply with the other criteria required for this classification
- A debt instrument which is redeemable by the issuer, to the extent that the book value would be substantially recovered were the purchase option to be executed
- Shares which have a fixed maturity (or are redeemable by the issuer) which have been classified as liabilities by that issuer

Those which cannot be classified as held to maturity are:

- Shares or shareholdings
- An investment where the investor intends to hold onto it for an indefinite period of time or which obtains fixed or determinable payments
- An investment in which the investor is willing to sell in response to changes in market conditions
- A perpetual debt instrument which will pay interest in perpetuity
- An instrument which is redeemable at the issuer's discretion for an amount significantly lower than its amortised cost
- An instrument over which the holder has a put option on the issuer
- An asset for which the entity does not have sufficient resources to hold it until maturity
- An asset which is subject to legal restrictions

## 7.2. Valuation subsequent to initial recognition

They are valued at their amortised cost using the effective interest rate method.

## 8. Shareholdings in associated companies

### 8.1. Definition

It is an investment in an associate company. An associate is a company on which the parent company exerts significant influence, understood as the power to intervene in the entity's financial policy and operational decisions.

There is **significant influence** when the two following requirements are met:

- Shareholding in the company,
- And the power to intervene in financial and operating policy decisions of the investee, without having control or joint control over it.

Significant influence may be evidenced through any of the following ways:

- Representation on the Board of Directors of the investee company;
- Participation in the policy-making process, which may include decisions on dividends or other distributions.
- Transactions of relative importance with the investee;
- Exchange of management personnel; or
- Supply of essential technical information.

Unless there is evidence to the contrary, it is presumed that there is significant influence when one or more companies in the group hold at least 20% of the voting rights of a company that is not a member of the group.

### 8.2. Application of the equity method

Investments in companies over which significant influence is exerted or which are jointly controlled are accounted for using the equity method.

#### 8.2.1. Initial valuation

Under the equity method, the investment in an associate or joint venture will be recorded at cost on initial recognition, with the book value being increased or decreased to recognise the investor's share of the investee's profit or loss after the acquisition date.

The investment will be accounted for from the date it becomes an associate. At the time of acquiring the investment, any difference between the cost of the investment and the entity's share in the net fair value of the investee's identifiable assets and liabilities will be accounted for as follows:



- The capital gain related to an associate shall be included in the book value of the investment and amortisation of that capital gain shall not be allowed.
- Any excess of the entity's share in the net fair value of the investee's identifiable assets and liabilities on the cost of the investment shall be included as income for the determination of the entity's share in the profit or loss of the period of the associate or joint venture in the period in which the investment is acquired.

When applying the equity method, the associate's most recently available financial statements will be used. When the year-end on which the entity and associate report are different, the associate will, for use by the entity, will prepare financial statements referring to the same date, whenever practical to do so. When the financial statements refer to a different date, relevant adjustments shall be made to reflect the effects of significant transactions or events which have occurred between the two dates mentioned. In no case will the difference between the end of the reporting period be greater than three months.

### 8.2.2. Subsequent valuation

Investments in the equity of associate companies will be valued at cost less, where appropriate, of any accumulated impairment losses.

The investor's share in the investee's results of the period will be recognised in the results of the investor's period. Distributions received from the investee will reduce the book value of the investment. Adjustments to the amount may be necessary due to changes in the investor's proportional shareholding in the investee arising from changes in the other comprehensive profit/(loss) of the investee. These changes include those arising from the revaluation of property, plant and equipment and currency conversion differences. The share corresponding to the investor in those changes will be recognised in the investor's comprehensive profit/(loss).

If an entity's share in the losses of an associate or joint venture equals or exceeds its interest in them, the entity will cease to recognise its shareholding in the additional losses. The shareholding in an associate or joint venture will be the book value of the investment in the associate or joint venture determined in accordance with the equity method, together with any long-term shareholding which, in essence, forms part of the net investment of the entity in the associate or joint venture. For example, an item for which no cancellation is expected nor is expected to occur in the foreseeable future is essentially an extension of the entity's investment in that associate or joint venture. Such items could include preferred shares and long-term loans or receivables but not those which would be trade receivables or payables nor long-term receivables for which there is adequate collateral, such as secured loans. Losses recognised under the equity method above the entity's investment in ordinary shares will be applied to the other components of the entity's investment in an associate or joint venture, in reverse order of precedence (i.e. their priority in the event of liquidation).

Once the entity's shareholding is reduced to zero, additional losses will be maintained and a liability will be recognised, only to the extent that the entity has incurred legal or implied obligations, or made payments on behalf of the associate or joint business. If the associate or joint venture subsequently reports gains, the entity will resume the recognition of its shareholding only after its shareholding in the aforementioned gains equals the shareholding in unrecognised losses.

If a shareholding in an associate or joint venture is reduced but the entity continues to apply the equity method, the entity reclassifies the proportion of the gain or loss previously recognised in other comprehensive income the proportion of the gain or loss previously recognised in other comprehensive income relative to such a reduction in shareholding in the event that such gain or loss requires reclassification to profit or loss for the period at the time of disposition of related assets or liabilities.

Specifically, the subsequent valuation would be defined as follows:

#### Subsequent valuation:

- (+) Initial valuation
- (-) Impairment or loss of value
- (+/-) Profit/(loss) of the shareholding corresponding to the investor
- (+/-) Changes in the shareholding
- (-) Dividends received

#### Example

Company A acquires 20% of company B, over which it exerts significant influence, for 500 thousand monetary units. Company A registers an initial investment of 500 thousand monetary units.

In the consolidation of the first year, supposing that the acquisition date coincides with the end date, the following entry will be made:

| Account | Description                                      | Debit   | Credit  |
|---------|--|---------|---------|
| 923     | Investments in companies using the equity method | 500,000 |         |
| 24XX    | Investments in associate companies               |         | 500,000 |

The following year, company B makes profits of 100 thousand monetary units. In addition, the following information is known: During the year, B sold inventories to A for 200 thousand monetary units which had cost it 150 thousand monetary units and which, on the end date, A holds in its financial statements.

A subsidiary of the group of A, has built a new warehouse for B, which sold it with a margin of 300 thousand euros.

The entries which have to be recognised in the consolidation of year 2 would be the following:

| Account   | Description                                      | Debit   | Credit  |
|---|--|---------|---------|
| 923X  | Investments in companies using the equity method | 520,000 |         |
| 924X  | Profit/(loss) of the equity method in companies  |         | 20,000  |
| 24XX  | Investments in associate companies               |         | 500,000 |
| <i>Reclassification of the amount of the shareholding in A and increase by the profit of B (100,000*20%=20,000)</i> |  |         |         |

| Account   | Description                                      | Debit  | Credit |
|---|--|--------|--------|
| 923X  | Investments in companies using the equity method | 10,000 |        |
| 35XX  | Inventories (*)                                  |        | 10,000 |
| <i>By eliminating the margin on inventories (50,000*20%=10,000)</i> |  |        |        |

| Account   | Description                                      | Debit  | Credit |
|---|--|--------|--------|
| 7XXX  | Income from the sale of fixed assets (**)        | 60,000 |        |
| 923X  | Investments in companies using the equity method |        | 60,000 |
| <i>By eliminating the margin on fixed assets<br/>(300,000*20%=60,000)</i> |  |        |        |

(\*) International standards allow the counterpart of this entry to be either the asset (inventories in this case) or the investment account in companies accounted for using the equity method.

(\*\*) International standards allow the counterpart of this entry to be either the net amount against the income item (as reflected in this example) or against the corresponding gross amounts of income and expense items.

### 8.2.2.1. Impairment losses

At each year-end, the Group assesses the existence of indicators of a potential impairment of the investment in the associate in order to recognise the related impairment loss, where appropriate

In order to determine the recoverable value of investments in companies whose only assets are real estate inventories, the company obtains valuations from independent experts. For the other companies, valuations of discounted cash flows are used as explained in the chapter "Impairment loss".

### 8.2.3. Discontinuation of use

An entity shall discontinue the use of the equity method from the date its investment ceases to be an associate or joint venture as follows:

- If the investments becomes a subsidiary, the entity will account for its investment in accordance with IFRS 3.
- If the retained shareholding in the former associate or joint venture is a financial asset, the entity will measure the retained shareholding at fair value. The fair value of the retained shareholding will be considered at its fair value at initial recognition as a financial asset in accordance with IFRS 9. The entity will recognise the profit for the period as the difference between:
  - o The fair value of any retained investment and the proceeds from the disposal of the part of the shareholding in the associate or joint venture; and
  - o The book value of the investment on the date the equity method was discontinued.
- When an entity discontinues the use of the equity method it will account for all the previously recognised amounts in other comprehensive profit/(loss) in relation to that investment on the same basis which would have been required had the investee disposed of the related assets and liabilities directly.

Therefore, when an equity method is discontinued, if a previously recognised gain or loss in other comprehensive profit/(loss) by an investee has been reclassified to profit or loss for the period at the time the related assets or liabilities were disposed, the entity will reclassify the gain or loss on equity to profit or loss for the period (as an adjustment for reclassification). For example, if an associate or joint venture has cumulative exchange rate differences relating to foreign businesses and the entity discontinues the use of the equity method, the entity reclassifies the gain or loss previously recognised as profit or loss for the period in other comprehensive profit/(loss) in relation to the overseas business.

## 9. Other financial liabilities

### 9.1. Definition

This category is residual. All liabilities are within this category apart from liabilities for trading, liabilities designated at fair value with changes in profit and loss and derivatives which are hedging instruments. The most common examples are trade creditors, loans received and customer deposits.

## 9.2. Valuation subsequent to initial recognition

Subsequent to initial recognition, financial liabilities are valued at their amortised cost, calculated using the effective interest rate method, except in the following cases which are valued at their fair value:

- Liabilities at fair value with changes in profit and loss
- Those arising from the transfer of a financial asset
- Those arising from the transfer of a financial asset
- Those which are commitments to offer loans at a lower interest rate than the market and are not measured at fair value with changes in profit or loss
- Financial guarantee contracts

## 10. Obligations and convertible bonds

### 10.1. Definition

A bond or instrument which is convertible will give rise to a financial liability (a contractual arrangement to deliver a financial liability (a contractual agreement to deliver cash or another financial asset) and an equity instrument (a call option which grants the holder, for a certain period, the right to convert it into a fixed number of ordinary shares in the entity).

### 10.2. Registration and valuation

The issuer of a convertible obligation into shares will first determine the book value of the liability component using the fair value of a similar liability which does not involve an equity component (but which does include, where applicable, any non-equity embedded derivatives). The book value of the equity instrument represented by the option to convert the instrument into ordinary shares will be determined by deducting the fair value of the financial liability from the fair value of the composite financial instrument considered as a whole.

When converting the convertible instrument at the time of maturity, the entity will write off the liability component and recognise it as equity. The original equity component will remain as such (albeit transferred from one equity item to another). The conversion at maturity does not produce any gain or loss.

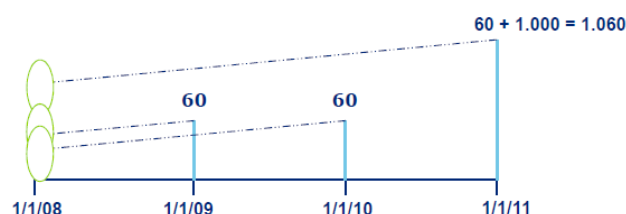
#### Example

Company XYZ issues 2,000 convertible bonds on 1 January 2008. The bonds have a maturity of three years and issued at par with a nominal value of 1,000 euros per bond.

- The interest on the bonds (6%) is payable annually.
- Each bond is convertible, at the option of the holder and at any time until maturity into 250 ordinary shares in XYZ.
- At the time of issuing the bonds, the interest rate for a debt with a risk similar to that of XYZ but without the option of converting the bonds into shares is 9%.
- Required: To account for the bond issued by XYZ at the time of its issue.

- Step 1: Calculate the market value of the liability component:

The discounted cash flow of the bond will be:



$$MV = \frac{60}{(1 + 0.09)} + \frac{60}{(1 + 0.09)^2} + \frac{60}{(1 + 0.09)^3} = 924.06 \text{ euros}$$

Total = 924.06 x 2,000 shares = 1,848,122 euros

- Step 2: Calculate the residual value of the equity part:
  - Total cash received at the time of issuing the bonds - 2,000,000
  - Market share of the debt component = (1,848,122) — — —
  - Residual value of the equity component = 151,878
- Step 3: Accounted for:

| Account | Description            | Debit     | Credit    |
|---------|------------------------|-----------|-----------|
| 572x    | Cash                   | 2,000,000 |           |
| xxxx    | Financial debt (bonds) |           | 1,848,122 |
| xxxx    | Equity                 |           | 151,178   |

## 11. Derivatives

### 11.1. Definition

A derivative is a financial instrument:

- Whose value changes in response to the changes of a variable named "underlying"
- Which, from the outset, requires a very small or zero net investment with respect to other types of contract which include a similar response to changes in market conditions
- Which will be settled on a future date

The Group is exposed to hedging derivatives; mainly exchange rates and interest rates. In order for these financial instruments to be classified as accounting hedges, they are initially designated as such, and the hedge relationship is documented. Also, the Group initially and periodically verifies that the hedge relationship is effective over the course of its life (at least in each accounting period), i.e. that it is prospectively expected that changes in fair value or cash flows of the hedged item (attributable to the hedged risk) are almost completely offset by those of the hedging instrument and that, retrospectively, the hedging results have fluctuated within a range of 80% to 125% over the item hedged.

### 11.2. Conditions for applying hedge accounting

Hedge accounting is only allowed if all the following conditions are met:

- There is formal designation and written documentation at the start of the hedge.
- The effectiveness of the hedge can be measured reliably. This requires that the fair value of the hedging instrument and the fair value (or cash flows) of the hedged item with respect to the risk being hedged can be obtained reliably.
- It is expected that the hedge will be highly effective in achieving fair value or cash flows in accordance with the initially documented risk management strategy.

- The hedge has been evaluated and has been found to be highly effective, on an ongoing basis, during the hedge relationship. It will be highly effective if the changes in fair value or expected cash flows of the hedged item attributable to the hedged risk lie within the range of 80% - 125%.
- In hedging the cash flows of an intended transaction, such a transaction is highly probable and creates an exposure to the variability of cash flows which could ultimately affect the results.

### 11.3. Checking the efficacy

The Group should check the efficacy at each reporting date. Coverage is considered high effective, at inception (retroactively) and on subsequent assessment dates (prospectively), when the following conditions are met:

- The hedge is expected to be highly effective in offsetting changes in fair value or in cash flows attributable to the hedged risk during the period for which the hedged risk is designated or the period until the amount of the hedging instrument is adjusted again. (prospective efficacy). The estimated results of the hedge for each period should be within the range of 80 - 125% (prospective efficacy). However, in order to improve the efficacy of the hedging ratio, a slight inefficacy in hedging could be established at inception to maximise expected efficacy.
- The real results of the hedge are within the range 80%-125% (retroactive efficacy)

If any of the above checks fail, hedge accounting cannot be applied at all. Even when a hedge relationship is expected to be highly effective and meets the efficacy criteria retroactively, inefficacy may appear within it. Such inefficacy must be immediately recognised in profit/(loss), even if it falls within the stated range.

### 11.4. Registration and valuation

Derivatives are valued at their market value on their contracted date and subsequent changes are recorded as follows:

- For fair value hedges, the differences produced in both the hedging elements as well as in the hedged elements (regarding the kind of risk hedged) are directly recognised in the profit and loss for the year.
- For cash flow hedges, valuation differences in the effective part of the hedge elements are temporarily recognised in the equity item "Equity valuation adjustments" and not recognised as results or until the hedged element matures. The ineffective part of the hedge is directly entered into the consolidated comprehensive profit and loss statement.

|                                  | Hedged item   | Hedging instrument   |
|----------------------------------|---|--|
| Accounting for fair value hedges | The gain or loss of the hedged item attributable to the hedged risk is recognised in the profit and loss account.   | The recognition and valuation of the hedging instrument is made in accordance with the general requirements applicable to said instrument and are not modified when applying the hedge accounting. |
| Accounting for cash flow hedges  | The recognition and measurement of the hedged item is carried out in accordance with the general requirements applicable to said instrument and are not modified when applying the hedge accounting (except for the adjustments of the basis at the end of the life of the hedge) . | The gain or loss on the hedging instrument attributable to the hedged risk, which is determined as effective hedge, is recognised in total income and expenses.                                    |

Hedge accounting is interrupted when the hedging instrument expires or is sold or finalised or exercised, or when it no longer meets the hedge accounting criteria. At that time, any cumulative gain or loss corresponding to the hedging instrument that has been recognised in equity is kept there until the expected transaction is undertaken.

Derivatives embedded in other financial instruments or in other main contracts are recognised separately as derivatives only when their risks and characteristics are not closely related to those of the main contract and providing such main contracts are not valued at fair value with changes in the profit and loss account.

## 12. Fair value

### 12.1. Definition

Fair value is the price which would be received for selling an asset or paid for transferring a liability in an orderly transaction between market participants at the measurement date (see detailed definition for financial instruments in 5.1).

### 12.2. The asset or liability

A fair value measurement is for a specific asset or liability. Therefore, when measuring the fair value an entity shall take into account the characteristics of the asset or liability in the same way that market participants would take them into account when setting the price of that asset or liability on the measurement date. By way of an example, these characteristics include the following elements:

- The condition and location of the asset; and,
- Restrictions, if any, on the asset's sale and use.

### 12.3. The transaction

A fair value measurement will imply that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability on the measurement date under present market conditions.

A fair value measurement will imply that the sale of the asset or transfer of the liability takes place:

- On the *main market* of the asset or liability; or
- In absence of the main market, on the *most advantageous market* for the asset or liability.

### 12.4. Market participants

An entity will measure the fair value of an asset or liability under the assumptions that the market participants would use to fix the price of the asset or liability, supposing that the market participants act in their best economic interest.

### 12.5. The price

Fair value is the price which would be received for the sale of an asset or which would be paid for the transfer of a liability in an ordered transaction on the main (or most advantageous) market on the measurement date under present market conditions (i.e. an exit price) regardless of whether that price is observable directly or estimated using another valuation technique.



### 13. Amortised cost

The amortised cost of a financial instrument is the amount at which a financial asset or a financial liability was initially valued, minus repayments of principal which have occurred, plus or minus, as the case may be, the part allocated to the profit and loss account using the effective interest rate method, of the difference between the initial amount and the amount of repayments at maturity, and for the case of financial assets, minus any impairment losses which would have been recognised.

#### 13.1. Calculation of the effective interest rate

The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and allocating interest income or expenses over the relevant period.

Unlike the straight-line method, this method reflects a constant return on the book value of the asset or liability.

##### 13.1.1. Definition of the effective interest rate

It is the update rate which equates the book value of a financial instrument with the estimated cash flows over the expected life of the instrument, based on its contractual conditions and without considering future credit risk losses.

It is the rate which exactly discounts the estimated current future payments or cash receipts, regardless of future credit losses, over the expected life of the financial instrument or until the next interest rate review date based on market prices, with the net book value of the financial asset or liability at the time of its initial recognition.

##### 13.1.2. Calculation of the effective interest rate

It is calculated on initial recognition of an instrument.

In the case of financial instruments at variable rates, the periodic review of the estimate of cash flows modifies the effective interest rate. To calculate the effective interest rate corresponding to each period, the effective interest rate will be applied to the amortised cost of the asset or liability at the end of the previous period.

#### Example

Suppose that a financial institution grants the Group a fixed rate loan of 50,000 m.u. to be returned in a single payment in 4 years at a nominal rate of 4% per annum, payable annually, and an opening commission of 1,000 m.u.

- Step 1: calculate the cash flows of the operation:

| Year | Cash flows |
|------|------------|
|      | 49,000     |
| 1    | (2,000)    |
| 2    | (2,000)    |
| 3    | (2,000)    |
| 4    | (52,000)   |

- Step 2: calculate the effective interest rate of the operation:

It is the rate applied for the discount of future flows, equating the sum of these with the initial investment:



$$49.000 = \frac{2.000}{(1+i)} + \frac{2.000}{(1+i)^2} + \frac{2.000}{(1+i)^3} + \frac{52.000}{(1+i)^4}$$

The rate (i) which complies with equality is 4.56%.

If the operation had no opening fee, the effective interest rate would be the same as the nominal interest rate (4% in this case), and therefore applying the amortised cost would simply accrue nominal interest.

- **Step 3:** Determination of the amortised cost:

The amortised cost in a specific period is the initial net amount adding or subtracting the interest accruals using the effective interest rate, plus or minus the collections or payments of the operation.

In the previous example, it would be:

| Year | Amortised cost at the start of the period | Expenses for interest | Cash flows (payments) | Amortised cost at the end of the period |
|------|---|-----------------------|-----------------------|---|
| 1    | 49,000                                    | 2,234                 | (2,000)               | 49,234                                  |
| 2    | 49,234                                    | 2,244                 | (2,000)               | 49,478                                  |
| 3    | 49,478                                    | 2,255                 | (2,000)               | 49,733                                  |
| 4    | 49,733                                    | 2,267                 | (52,000)              | -                                       |

## Items

| Account | Description                                 | Debit  | Credit |
|---------|---|--------|--------|
|         | <i>Time 0</i>                               |        |        |
| 572     | Banks                                       | 49,000 |        |
| 170/520 | LT/ST Debts with credit institutions        |        | 49,000 |
|         | <i>Recognition of the initial bank debt</i> |        |        |
|         | <i>Year 1</i>                               |        |        |
| 6640    | Loan interest                               | 2,234  |        |
| 170/520 | LT/ST Debts with credit institutions        |        | 234    |
| 572     | Banks                                       |        | 2,000  |
|         | <i>For payment of the year 1 amount</i>     |        |        |
|         | <i>Year 2</i>                               |        |        |
| 6640    | Loan interest                               | 2,244  |        |
| 170/520 | LT/ST Debts with credit institutions        |        | 244    |
| 572     | Banks                                       |        | 2,000  |
|         | <i>For payment of the year 2 amount</i>     |        |        |
|         | <i>Year 3</i>                               |        |        |
| 6640    | Loan interest                               | 2,255  |        |
| 170/520 | LT/ST Debts with credit institutions        |        | 255    |
| 572     | Banks                                       |        | 2,000  |
|         | <i>For payment of the year 3 amount</i>     |        |        |
|         | <i>Year 4</i>                               |        |        |
| 6640    | Loan interest                               | 2,267  |        |
| 170/520 | LT/ST Debts with credit institutions        | 49,733 |        |
| 572     | Banks                                       |        | 52,000 |
|         | <i>For payment of the final amount</i>      |        |        |

# Accounting policy manual

## Treasury shares

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June 2017

Approved by:

SVP Consolidation and  
Internal Control

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## Treasury shares

### 1. SCOPE

This accounting policy will be applied to the treasury shares acquired by the Group.

The accounting criteria under this policy are derived from the following regulation:

| IAS / IFRS | Description                          |
|------------|--------------------------------------|
| IAS 32     | Financial instruments: presentation. |

### 2. Executive Summary

| Area                                  | Concepts  | Ref. |
|---------------------------------------|---|------|
| <b>Definition</b>                     |   |      |
| Definition                            | Treasury shares are equity instruments and consist of Group shares acquired and held temporarily by it.                                     | 3    |
| <b>Types</b>                          |   |      |
| Treasury shares in special situations | Those acquired by the company without a capital reduction agreement approved by the General Meeting.  | 4.1. |
| Treasury shares for capital reduction | Those treasury shares acquired by the company to execute a capital reduction agreement approved by the General Meeting.                     | 4.2. |
| <b>Registration and valuation</b>     |   |      |
| Initial valuation                     | Treasury shares are presented as a reduction in the Group's equity and their initial valuation is the amount received net of issuing costs. | 5.1. |
| Disposal                              | The profits and losses obtained by the Group on the disposal of these treasury shares are recorded in the "Share premium" item.             | 5.2. |

### 3. Definition

Treasury shares are own equity instruments, i.e., they represent a residual interest in the Group's equity once all their liabilities are deducted, and consist of Group shares acquired and temporarily held by it.

### 4. Types

#### 4.1. Treasury shares in special situations

Those acquired by the company without a capital reduction agreement approved by the General Meeting.

Their acquisition should be approved by the General Shareholders' Meeting. When the aim is to acquire shares in the parent company, authorisation should also be obtained from their General Meeting.

The nominal value of the acquired treasury shares added to those already held by the acquiring company cannot exceed 5 per cent of the share capital.

## 4.2. Treasury shares for capital reduction

Those treasury shares acquired by the company to execute a capital reduction agreement approved by the General Meeting. Given that the aim of these shares is to reduce capital, compliance with the requirements set out in the previous paragraph is not required.

The exercise of voting rights and other political rights included within the treasury shares shall be suspended and the purchase must be offered to all shareholders. The shares should be amortised the within a month following the ending of the purchase offer period.

## 5. Registration and valuation

### 5.1. Initial valuation

Treasury shares are presented as a reduction in the Group's equity and their initial valuation is the amount disbursed net of issuing costs.

### 5.2. Disposal

The profits and losses obtained by the Group on the disposal of these treasury shares are recorded in the "Reserves" item.

## 6. Examples

### *Purchase of treasury shares*

Company XYZ, in accordance with the authorisation of the General Shareholders' Meeting, acquired 10,000 treasury shares for 108,182 euros on 30/06/x+1.

| Account        | Description     | Debit   | Credit  |
|----------------|-----------------|---------|---------|
| 198            | Treasury shares | 108,182 |         |
| 570            | Bank            |         | 108,182 |
| At 30 June X+1 |                 |         |         |

### *Disposal of shares*

On 31/10/X+1, the remaining 5,000 were disposed of at a quoted price of 9.92 euros per share giving a total value of 49,600 euros.

| Account           | Description     | Debit  | Credit |
|-------------------|-----------------|--------|--------|
| 570               | Bank            | 49,600 |        |
| 11X               | Legal           | 4,491  |        |
| 198               | Treasury shares |        | 54,091 |
| At 30 October X+1 |                 |        |        |

## 7. Related regulations

1. Financial instruments. See module ["Financial instruments"](#)
2. Share-based payments See module ["Share-based payments"](#)

# Accounting policy manual

## Subsidies

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## Subsidies

### 1. Scope

This accounting policy will be applicable to the subsidies granted by Public Administrations to the Grupo NH companies, so contributions made by Group companies to other Group companies would be outside the scope of this chapter.

- The accounting criteria under this policy are derived from the following international regulation:

| IAS / IFRS | Description  |
|------------|--|
| IAS 20     | Accounting for Government Grants and Disclosure of Government Assistance |

### 2. Executive Summary

| Area   | Concepts  | Ref. |
|--|---|------|
| <b>Recognition</b>   |   |      |
| Requirements   | A subsidy will be recognised when the Group has reasonable assurance that it meets the associated terms and that it will be received in a predetermined manner. | 3    |
| General Criterion  | Subsidies are recognised as income on a systematic basis  | 3.1. |
| <b>Valuation and registration according to the nature of the subsidy</b> |   |      |
| Subsidies related to assets  | The Group has chosen to present them as deferred income items.  | 4.1. |
| Subsidies related to income  | Subsidies related to income are recognised as part of the profit or loss for the accrual period.  | 4.2. |
| <b>Return of government subsidies</b>                                    |   |      |
| Returns  | A prospective methods will be applied.  | 5    |
| <b>Non-monetary government subsidies</b>                                 |   |      |
| Valuation  | It is customary to determine the fair value of each non-monetary asset and account for both the subsidy and each asset at the corresponding fair value.         | 6    |

### 3. Recognition

Subsidies granted by Public Administrations are those Public Sector aids which involve a transfer of resources in exchange for an entity meeting certain conditions. Thus, government subsidies will be recognised if and only if there is reasonable assurance that:

- The Group will meet all the legal conditional attached to them; and
- The Group will receive such subsidies.



Grupo NH will not recognise a government subsidy, including non-monetary subsidies, until there is reasonable assurance that the Group will meet the conditions attached to it and will receive it in the predetermined manner. However, receiving a subsidy will not imply conclusive evidence that the conditions associated with such subsidy have been or will be met.

### 3.1. General criterion

Subsidies are valued at the amount granted and recognised as income on a systematic basis. If the subsidy compensates for losses already incurred or has the sole purpose of providing financial support to the entity it is recognised immediately in the profit and loss account for the year.

### 3.2. Classification

There are two categories of government subsidy:

- Capital subsidy
- Operating subsidy

## 4. Valuation and registration according to the nature of the subsidy

### 4.1. Presentation of subsidies related to assets

Subsidies related to assets are those whose granting implies that the company must buy, construct or otherwise acquire fixed assets. The regulation contemplates two alternatives for the presentation of government subsidies related to assets (of non-repayable capital) in the financial statements, including non-monetary assets at fair value:

1. Recognise subsidies as deferred income, which will be recognised in profit or loss on a systematic basis over the useful life of the asset receiving the subsidy.
2. Deduct the subsidy when calculating the book value of the corresponding asset. The subsidy will be recognised in profit or loss over the life of an asset which will be amortised as a reduction of depreciation expense.

Grupo NH has chosen to present subsidies related to assets by recognising them as deferred income items and allocating them to profit or loss in proportion to the depreciation experienced during the year for the assets financed from these subsidies. Therefore:

$$\text{Allocation to profit or loss} = \text{Amount of Subsidy} \times \text{Percentage (\%)} \text{ of useful life}$$

Any change of criterion considered within current regulations must be approved by Grupo NH's Accounting Policy Director.

#### Example 1

Grupo NH is the beneficiary of a subsidy. However, at the closing date, the body which granted it has not yet made the payment.

#### 1.1. At the time granted:

| Debit  |    | Credit                |
|--|----|-----------------------|
| (4708) Public Treasury, debtor for subsidies granted |    |                       |
|  | to | (438) Deferred income |

#### 1.2. At the time of collection

| Debit      |    | Credit   |
|------------|----|--|
| (572) Cash |    |  |
|            | TO | (4708) Public Treasury, debtor for subsidies granted |

At the end of the year, Grupo NH will allocate deferred income to profit or loss to the same extent as the asset the subsidy financed during the year has depreciated:

| Debit                 |    | Credit                            |
|-----------------------|----|-----------------------------------|
| (438) Deferred income |    |                                   |
|                       | TO | (7XX) Income from Subsidies (P/L) |

### Example 2

On 01/01/20X0, Grupo NH Hoteles receives a subsidy consisting of the use, for 3 years, of computer equipment. The market value of a 3-year computer equipment lease is 1,000 and its amortisation is on a straight line basis.

#### Accounting entry:

##### 1.1. At the time of receiving the subsidy:

| Debit                                       |    | Credit                      |
|---|----|-----------------------------|
| 1,000 (207) Right on assigned assets in use |    |                             |
|   | to | (438) Deferred income 1,000 |

##### 1.2. At the end of the following three years:

| Debit                        |    | Credit                                   |
|------------------------------|----|--|
| 333.33 (438) Deferred income |    |  |
|                              | to | (7XX) Income from Subsidies (P/L) 333.33 |

| Debit  |    | Credit  |
|--|----|---|
| 333.33 (680) Intangible asset amortisation charges |    |   |
|  |    | (280) Cumulative Amortisation of intangible assets 333.33 |
|  | to |   |

## 4.2. Presentation of operating subsidies

The regulations accept two alternatives regarding the presentation of the subsidies related to income:

1. Present the subsidies related to income as part of the profit or loss for the period by separating the subsidies and corresponding expenses. This makes it easier to compare with other expenses not affected by subsidies.
2. Present subsidies related to income under general denominations such as "other income", appearing alternatively as deductions from the expenses with which they relate. By following this method, the concept of subsidies is considered jointly, since the costs would not have been incurred in case of not having the subsidies and, therefore, the presentation could be equivocal of not compensating the expenses and the subsidies .

Grupo NH will present the subsidies related to income as part of the profit or loss for the period at the time of its accrual separately (option 1). Therefore, for the treatment of this type of subsidy, refer to IAS 18 and see chapter "Recognition of Income".

In any case, any change of criterion considered within current regulations must be approved by Grupo NH's Accounting Policy Director.

## 5. Return of subsidies from Public Administrations

Grupo NH will account for government subsidies which become repayable as a change in an accounting estimate (see IAS 8). Thus, the return of a subsidy related to income will firstly offset any unamortised deferred amount accounted for in connection with the subsidy. To the extent that the repayment exceeds the amount deferred, or if it does not exist, the repayment will be recognised immediately in profit or loss for the period.

The return of a subsidy related to an asset will be recognised as an increase in the book value of the asset, or as a reduction of the deferred income balance (based on the originally used criterion) for the amount to be repaid. The additional cumulative depreciation which would have been recognised in profit or loss to that date, in the absence of the subsidy, will be recognised immediately in profit or loss for the period.

In summary, government subsidy returns will have the same accounting treatment as a change in accounting estimate (IAS 8), i.e. the balance will be adjusted in the current year, without redoing previous years. That is, a prospective treatment is applied.

## 6. Non-monetary government subsidies

Government subsidies may take the form of transfers of non-monetary assets, such as land or other resources, for use by the entity. In these circumstances, it is customary to determine the fair value of each non-monetary asset and account for both the subsidy and each asset at the corresponding fair value.

## 7. Other related standards

1. Treatment of intangible assets. See module ["Intangible Assets"](#)
2. Treatment of Property, plant and equipment. See module ["Property, plant and equipment"](#)

## 8. Practical examples

The following example is offered for illustrative effects to show the most frequent accounting entries in the accounts of the module:

### 1. Example 1:

On 1 January 20X0, the Ministry of Education and Science grants Grupo NH a subsidy for the acquisition and installation of an audio system for the plenary hall, amounting to 20,000 euros and paid by the Ministry at the time it is granted. The Specification of the subsidy states that the totality of the subsidy granted must be destined to the financing of this asset:

- Amount of the subsidy: 20,000 euros
- Type of subsidy: Capital subsidy.
- Grant date: 1 January 20X0.

### Initial recognition

*Accounting entry:*

| Debit             |    |                       | Credit |
|-------------------|----|-----------------------|--------|
| 20,000 (572) Cash |    |                       |        |
|                   | to | (438) Deferred income | 20,000 |

### Subsequent recognition

On 1 April, Grupo NH purchases the audio system for which the subsidy was granted, with an acquisition cost of 40,000 euros.

*Accounting entries:*

a) For the purchase of property, plant and equipment:

| Debit                                      |    |                | Credit |
|--|----|----------------|--------|
| 40,000 (21X) Property, plant and equipment |    |                |        |
|  | to | (570) Treasury | 40,000 |

### Allocation to profit or loss

Since the subsidy was granted for the purchase of fixed assets by Grupo NH, it should be allocated to profit or loss in accordance with the amount of the depreciation of the items purchased.

For further information on the depreciation of tangible assets, see chapter "Property, plant and equipment".

For our example we consider that the Group sets a useful life for the acquired audio system of 10 years.

Below shows the calculation made to know the monthly amortisation of the tangible asset acquired:

$$\begin{array}{l} \text{Amortisation rate of the period} \\ \text{(month):} \end{array} \quad \frac{\text{Amortisable basis: €40,000}}{\text{Years of useful life: 10 years}} \times \frac{1}{12 \text{ months}} = \text{€334/month}$$

And the allocation of the subsidy to the profit and loss account will be as follows:

$$\begin{array}{l} \text{Amortisation rate of the period} \\ \text{(month):} \end{array} \quad \frac{\text{Amortisable basis: €20,000}}{\text{Years of useful life: 10 years}} \times \frac{1}{12 \text{ months}} = \text{€167/month}$$

For the depreciation of the technical installation:

| Debit  |    | Credit   |
|--|----|--|
| 334 (681) Property, plant and equipment amortisation charges |    |  |
|  |    | (281) Cumulative Amortisation of property, plant and equipment 334 |
|  | to |  |

Simultaneously, by the allocation of the subsidy related to assets to profit or loss:

| Debit                     |    | Credit                                |
|---------------------------|----|---------------------------------------|
| 167 (438) Deferred income |    |                                       |
|                           | to | (XXX) Income from Subsidies (P/L) 167 |

**NOTE:** The depreciation entry, as well as the corresponding allocation of the subsidy to the profit and loss account, must be made monthly until the asset has been fully depreciated.

## 2. Example 2:

On 1 January 20X0, the Ministry of Education and Science grants Grupo NH a subsidy for operating expenses, amounting to 50,000 euros. The specification of the subsidy does not state the specific expenditure to be incurred with the subsidy granted, although it is specific to the current expenditure of the 20X0 financial year:

- Amount of the subsidy: 50,000 euros

- Type of subsidy: Operating subsidy

| Debit             |    | Credit   |
|-------------------|----|--|
| 50,000 (572) Cash | to | (7XX) Official operating subsidies (Income) 50,000 |

**NOTE:** The Group must justify the realisation of current expenses amounting to 50,000 euros. In the event that the expenses incurred are less than 50,000 euros, the unrealised amount must be repaid to the Ministry, and a check must be made to reduce the amount of the subsidy income, recognising an account payable to the Ministry for the amount to be refunded.

# Accounting policy manual

## Provisions, contingent assets and liabilities

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Approved by:

SVP Consolidation and  
Internal Control

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## Provisions, contingent assets and liabilities

### 1. Scope

This accounting policy will apply to provisions, contingent assets and liabilities of any nature including litigation, except those dealt with by a specific standard and detailed below.

The accounting criteria under this policy are derived from the application of the following international regulation:

| IAS / IFRS | Description  |
|------------|--|
| IAS 37     | Provisions, contingent assets and contingent liabilities |

This standard determines the accounting criteria to be applied to the forecasts corresponding to the Group's obligations, not to the value corrections of certain assets or other provisions which are developed by other regulations.

Therefore, not included in this policy are:

- Obligations for employee benefits
- Provisions for restructuring and dismissals
- Liabilities for share-based payments (see chapter ["Share-based payments"](#))
- Provisions for impairment (see chapter ["Impairment of non- current assets"](#))
- Provisions for insolvencies

### 2. Executive Summary

| Area                               | Concepts   | Ref. |
|------------------------------------|--|------|
| <b>Initial recognition</b>         |  |      |
| Provisions                         | A provision is recognised when there is a legal or implied obligation arising from a past event if there is a probable outflow of resources and the amount can be estimated reliably.  | 3.1. |
| Contingent liabilities             | Contingent liabilities are present obligations with uncertainties about the probability of outflows of resources or the amount of such flows, as well as possible obligations whose existence is uncertain. Contingent liabilities are not recognised, they are broken down.           | 3.2. |
| Contingent assets                  | Contingent assets with possible (potential) assets which arise as a result of past events and whose occurrence/non-occurrence depends on one or more uncertain future events which are outwith the control of the company. Contingent assets are not recognised, they are broken down. | 3.4. |
| <b>Valuation of the provisions</b> |  |      |
| Valuation                          | A provision is valued for at best estimate of future outlays required to pay a present obligation, which should be discounted if the amount is expected to be released over a period of more than one year and the financial effect is significant.                                    | 4    |

| Other aspects        |   |      |
|----------------------|---|------|
| Onerous contracts    | Onerous contracts are those in which the inevitable costs of fulfilling the obligations they entail exceed the economic benefits expected from them. The Group follows the principle of recording a provision at the present value of the differences between the costs and benefits of the contract, or the compensation foreseen for abandonment, if such is decided. | 6.1. |
| Environmental policy | Provisions will be made when they meet the definition contained in this manual and expenses will be activated as established in the chapter "Property, plant and equipment"   | 6.2. |

### 3. Initial recognition

#### 3.1. Provisions

A provision is a commitment to a third party whose amount and/or moment of occurrence are not known with certainty.

The general criteria for recognition of a provision are as follows:

- There is a present, legal or implied, obligation derived from past events.
- Outflows of future economic benefits are likely to occur.
- A reliable estimate of the amount of the obligation can be made.

##### 3.1.1. Event which gives rise to the obligation

###### 3.1.1.1. Legal obligation

Normally arising from contracts or legislation.

###### 3.1.1.2. Implied obligation

Arises when the Group, by its past practices or by binding communications to the affected parties, has created a valid expectation in third persons that it will carry out an action.

An implied obligation is not generated by the decision made by the Group's management, since it does not create a valid expectation in third parties until the decision is communicated to them. Therefore, a decision must be communicated to create a valid expectation to third parties.

##### 3.1.2. Uncertainty about the existence of an obligation

In some cases it is not clear whether or not an obligation exists at a present time. In such circumstances, a past event results in a present obligation if it is probable that a present obligation (more than 50%) is likely to exist on the date of filing the information.

The assessment of whether a present obligation exists involves a judgement by management on a case-by-case basis, taking past experience into account regarding the pattern of claims arising from similar events and the circumstances surrounding the particular event giving rise to the obligation.

In cases where it is not clear whether there is a present obligation, the Group's management should consider whether, taking into account all possible evidence, a present obligation is likely.

An event that did not give rise to an obligation immediately may do so at a later date because of legal changes or actions by the Group which give rise to an implied obligation.

If the existence of an obligation depends on future actions of the Group, a provision should not be recognised until the obligation is inevitable.

No provision will be recorded for future losses arising from the company's activity, even if they are probable, unless they are related to an onerous contract.

*Example*

The Group receives a claim for failure to maintain a hotel. The mere receipt of the claim is not a present obligation, it is necessary to assess whether the claimant is likely to be correct on the basis of a probability assessment carried out by the Group.

### **3.2. Contingent liabilities**

A contingent liability is:

- A potential commitment, which depends on the occurrence (or non-occurrence) of certain future events (which are not under the control of the company), or
- A current commitment, for which settlement is not probable (although it may be possible) which comes from the Group's economic resources or whose amount can not be reliably measured.

Contingent liabilities are not recognised in the statement of financial position unless they are derived from a business combination. Contingent liabilities will be broken down in the annual accounts.

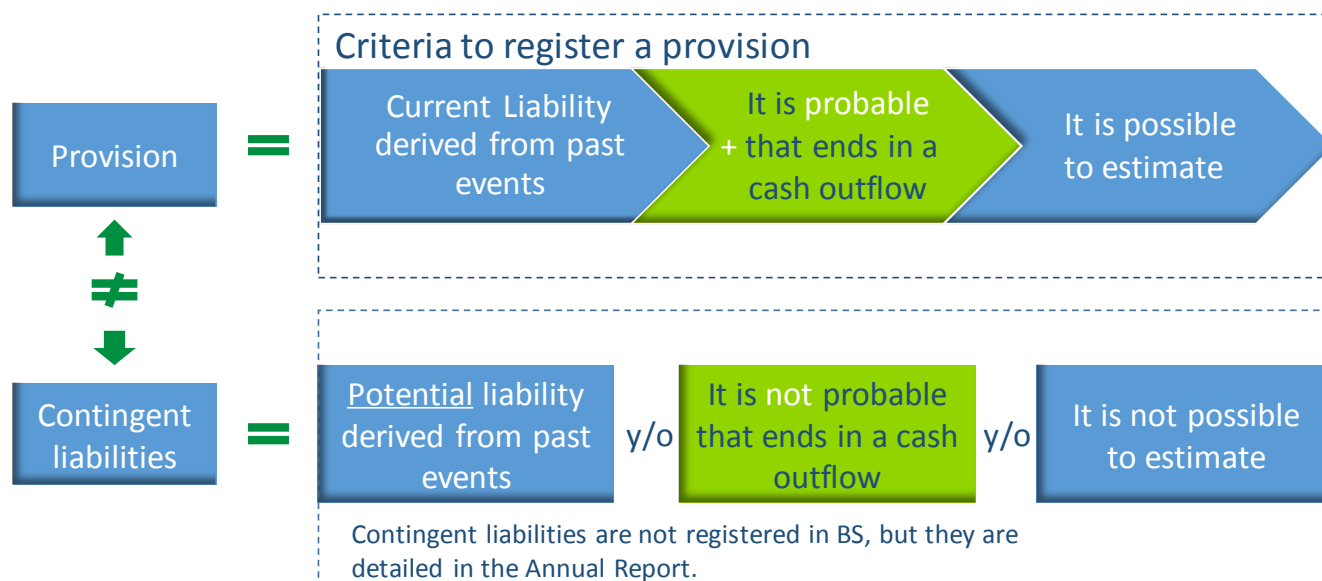
Contingent liabilities are continually re-evaluated in order to determine if an outflow of resources has become likely or whether the recognition criteria have been met. In the case of meeting the requirements, a liability would be recognised in the statement of financial position in the year in which the change occurred.

### **3.3. Relationship between provisions and contingent liabilities**

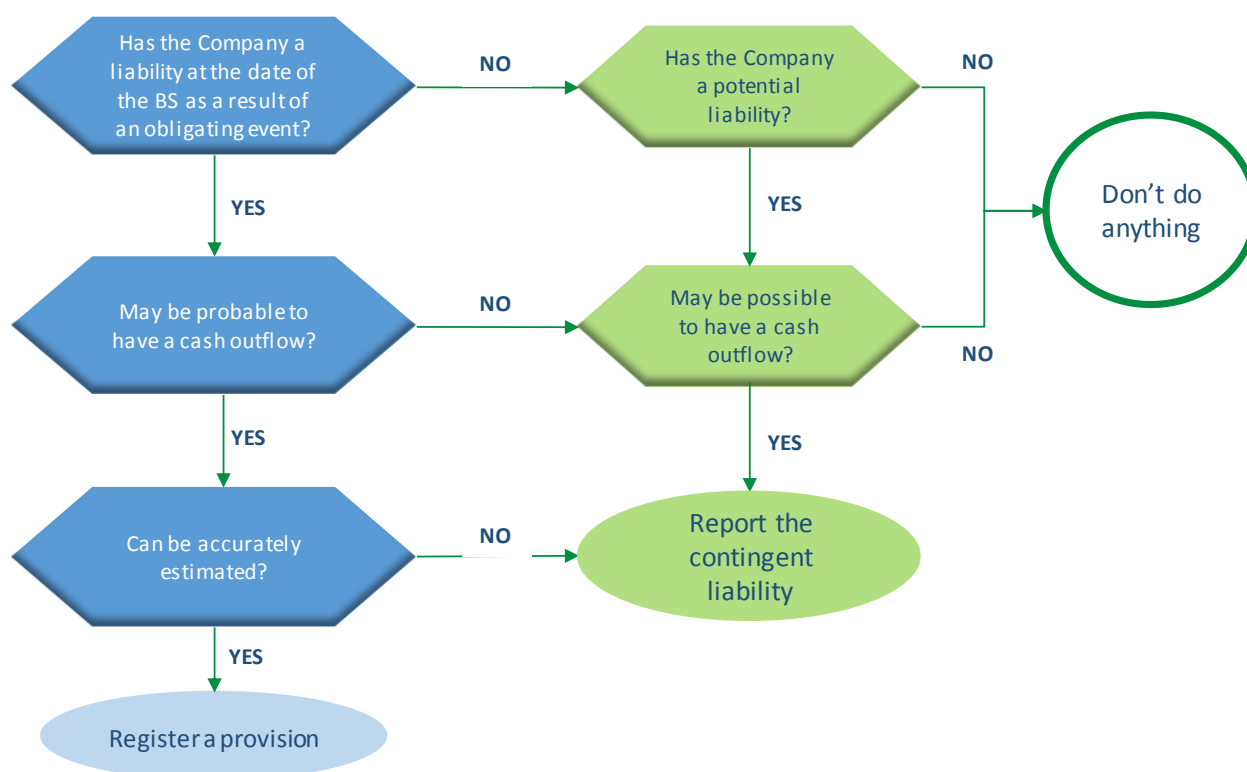
In a general sense, all provisions are contingent in nature, since there is uncertainty about the time of maturity or the amount involved. However, the term contingent when applied to assets and liabilities designates those which have not been recognised in the financial statements, because their existence will be confirmed only after the occurrence, or non-occurrence, of one or more uncertain future events which are not entirely under the control of the entity. On the other hand, the term "contingent liability" is used to refer to liabilities which do not meet the criteria for recognition.

Specifically:

- Provisions: they have been recognised as liabilities because they represent present obligations and it is probable that, in order to satisfy them, the entity has to dispose of resources which have economic benefits; and
- Contingent liabilities: which have not been recognised as liabilities because they are:
  - a) Possible obligations, insofar as it still has to be confirmed if the entity has a present obligation which can imply an exit of resources which have economic benefits; or
  - b) Present obligations which do not meet the criteria for recognition as defined for provisions.



The decision tree would be as follows:



### 3.4. Contingent assets

Possible (potential) assets which arise as a result of past events and whose occurrence/non-occurrence depends on one or more uncertain future events which are outwith the control of the Group.

Contingent assets are not recognised, although they are reported in the report, to the extent that the inflow of resources is probable.

When the inflow of resources is practically safe, the asset and the corresponding income are recognised in the financial statements of the period in which the change occurs.

## Example

The Group files a claim for 1,200,000 m.u. The lawyer reports that this indemnity is likely to be received. In this case, nothing should be recorded in the accounts, although this information should be broken down in the annual accounts.

In the following year, the receivable is practically cash. In this case, the asset would have to be recorded through the following entry:

| Account  | Description         | Debit     | Credit    |
|--|---------------------|-----------|-----------|
| 44XX   | Accounts receivable | 1,200,000 |           |
| 7XXX   | Gains and losses    |           | 1,200,000 |
| <i>At the time it is determined that it is practically certain</i> |                     |           |           |
| 572X   | Banks               | 1,200,000 |           |
| 44XX   | Accounts receivable |           | 1,200,000 |
| <i>When the amount is received</i>                                 |                     |           |           |

## 4. Initial valuation of the provisions

Provisions are recognised by the best estimate at the closing date of the outlay necessary to cancel the present obligation.

If the provision refers to an isolated case and not to a set of elements, as in the case of litigation, the amount by which the provision is recognised is the most probable outcome.

The valuation of provisions in the Group is made by internal advisors from the corresponding area or external advisors who will determine their probability and value; at a BU level the amounts that you notify will be recorded.

The Finance Department of each BU must keep an updated record of each of the facts or circumstances which could give rise to a provision, contingent asset and/or contingent liabilities, with an estimate of probabilities and value.

### 4.1. Risk and discount

In the case of provisions with a maturity of more than one year, and for which the financial effect is significant, it will be necessary to record the discounted value, given that the amount of the provision must be the present value of the outlays which are expected to be necessary to cancel the obligation.

The discount rate will be determined before taxes, considering the temporary value of the money, as well as the specific risks which have not been considered in the future flows related to the provision at each end date (see discount rate in chapter "Impairment of non- current assets").

## Example

The Group finds it likely to have to pay compensation for breach of a contractual clause within two years for an estimated amount of 2,000,000 m.u. In this case, if the present value of that provision were 1,683,360 m.u. in year zero and 1,834,862 m.u. in year one, the entries to make would be as follows:

| Account | Description  | Debit     | Credit    |
|---------|--|-----------|-----------|
|         | <i>In year 0</i>                                     |           |           |
| 6784    | Provision . Litigation and responsibilities          | 1,683,360 |           |
| 1420    | Provision for liabilities                            |           | 1,683,360 |
|         | <i>To record the provision for the current value</i> |           |           |

| Account | Description  | Debit   | Credit  |
|---------|--|---------|---------|
|         | <i>In year 1</i>                                     |         |         |
| 6690    | Other financial expenses                             | 151,502 |         |
| 1420    | Provision for liabilities                            |         | 151,502 |
|         | <i>To record the provision for the current value</i> |         |         |

| Account | Description  | Debit   | Credit  |
|---------|--|---------|---------|
|         | <i>In year 2</i>                                     |         |         |
| 6690    | Other financial expenses                             | 165,138 |         |
| 1420    | Provision for liabilities                            |         | 165,138 |
|         | <i>To record the provision for the current value</i> |         |         |

| Account | Description                        | Debit     | Credit    |
|---------|------------------------------------|-----------|-----------|
|         | <i>In year 2</i>                   |           |           |
| 1420    | Provision for liabilities          | 2,000,000 |           |
| 5720    | Banks                              |           | 2,000,000 |
|         | <i>To record the final payment</i> |           |           |

## 5. Subsequent valuation of the provisions

Provisions should be reviewed at each reporting date and adjusted to reflect the best estimate at that time.

If the outflow of resources ceases to be probable, the provision will be reversed.

Provisions will be used only to cover the outlays for which they were originally recognised (specific designation) and are charged to profit or loss in the respective accounts which correspond to them according to their nature.

### 5.1. Legal costs associated with the defence of claims

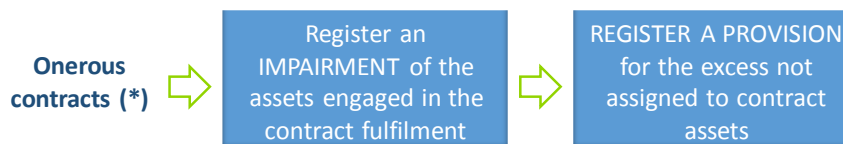
If the Group believes that there is no past event which gives rise to an obligation, the legal costs which it is expected to incur in defending the claim should not be accounted for as a provision. Such costs will be treated as future operating expenses and will be recognised as expenses when incurred.

## 6. Other aspects

### 6.1. Onerous contracts

Onerous contracts are those in which the inevitable costs of fulfilling the obligations they entail exceed the economic benefits expected from them. The unavoidable costs of the contract will reflect the lower net costs of resolving it, or that which is equal, the lower amount between the cost of complying with the clauses and the number of payments for compliance.

Present obligations arising from contracts must be recognised and measured in the financial statements as provisions. The Group follows the principle of recording a provision at the present value of the differences between the costs and benefits of the contract, or the compensation foreseen for abandonment, if such is decided. In addition, prior to provisioning for an onerous contract, the Group will recognise any impairment losses which correspond to the assets engaged in the performance of the obligations under the contract. This is:



It is common practice in the sector to continue operating those hotels under leases whose operating results are negative and, therefore, subject to an onerous contract. Behind this practice lies the fact that future losses from the hotel's operation are lower than those resulting from the early cancellation of the contract.

In this sense, Group Management must annually conduct an analysis of all lease contracts which cause losses to determine whether or not it is necessary to register a provision for onerous contracts.

## Example

The Group has one of its hotels operating under an operating lease. Although the operation of this hotel generated significant profits in previous years, it is now in deficit, with expenses higher than income. This happened in the year 20X0 and a similar situation is likely in the 3 years remaining on the contract, since two new hotels have been built in another more touristy area of the city. Specifically, the estimated difference between expenses, including rental, and income for the years 20X1, 20X2 and 20X3 is 50,000, 60,000 and 70,000 euros respectively. The operating income and expenses practically coincide with the payments and receivables of the period. The cancellation of the lease would mean the full payment of the rent of the remaining years which is 150,000, 160,000 and 170,000 euros. Considering the inherent risk of the operation, the appropriate discount rate is 5%. The company has chosen to continue operating this hotel during the remaining three years of the contract.

## Solution

The evolution of the economic situation, particularly applicable to the rented hotel, has made the lease an onerous contract, since the costs of complying with it are higher than the economic benefits it reports to the company. The operation of the hotel by the company entails a deficit of 50,000, 60,000 and 70,000 euros over the next three years. On the other hand, the alternative of cancelling the contract is even worse, given that it supposes 150,000, 160,000 and 170,000 euros in the following three years, amounts greater than the previous ones. Compliance of the obligation derived from the contract therefore generates outlays practically coinciding with the profit or loss since there is no amortisation of the 50,000, 60,000 and 70,000 euros respectively. Considering that the hotel is efficient in its operation, if we wanted to transfer the obligation of the contract to another company, it would require us to pay an approximate amount to what we are supposed to by complying with it, discounting a representative risk rate of the operation, in this case 5%.

## Items

| Account | Description   | Debit   | Credit  |
|---------|---|---------|---------|
| 6954    | Provisioning for onerous contracts<br><i>Amount: <math>50,000/1.05 + 60,000/1.05^2 + 70,000 / 1.05^3 = 162,509</math></i> | 162,509 |         |
| 4994    | Provision for long-term onerous contracts<br><i>Amount: <math>60,000/1.05^2 + 70,000 / 1.05^3 = 114,890</math></i>        |         | 114,890 |
| 4994    | Provision for short-term onerous contracts<br><i>Amount: <math>50,000/1.05 = 47,619</math></i>                            |         | 47,619  |

## 6.2. Environmental policy

Provisions for likely or certain liabilities, ongoing litigation and outstanding indemnities or obligations of an indeterminate amount connected with the environment and not covered by the insurance policies taken out are established at the time the liability or obligation linked to the indemnities or payment arises. The requirements

which give rise to the provision are the same as those described in section 3.1. of this manual, as well as the standards for registration and valuation.

Any expenses arising from environmental protection and improvement are recognised in profit or loss for the year in which they are incurred, irrespective of the moment when the cash or financial flows deriving from them arise.

Investments arising from environmental activities are valued at their original cost and capitalised as increases in the cost of fixed assets or inventory in the financial year in which they are incurred. In any case, the expenses activation policy will be made according to that established in the chapter "Property, plant and equipment".

### *Examples*

Company A manages the waste generated by its activity, so it does not suppose an improvement in the performance of its activity, but rather supposes compliance with regulations. In this case, the waste management will be accounted for as an expense for the company and not even an increase in the greater value of its assets.

Company B installs an emissions filter to reduce toxic gas outlets. This filter supposes an improvement in the performance of the company's business in environmental matters, and therefore can be accounted for as a greater value of the asset.

## **7. Related regulations**

1. Contingent liabilities derived from business combinations. See module ["Business combinations"](#)
2. Leases. See module ["Leases"](#)
3. Impairment of non- current assets. See module ["Impairment of non- current assets"](#)
4. Property, plant and equipment See module ["Property, plant and equipment"](#)





# Accounting policy manual

## Share-based payments

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Approved by:

SVP Consolidation and Internal  
Control

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## Share-based payments

### 1. Scope

This accounting policy will be applied to the remuneration to personnel in share-based payments whose settlement is in shares, in cash or with payment alternatives.

The accounting criteria under this policy are derived from the following international regulation:

| IAS / IFRS | Description          |
|------------|----------------------|
| IFRS 2     | Share-based payments |

### 2. Executive Summary

| Area                           | Concepts  | Ref. |
|--------------------------------|---|------|
| <b>Definitions</b>             |   |      |
| Share-based payments           | The delivery of shares of the company by its shareholders to employees are share-based payments, unless such delivery is not related to the provision of services by the employee. There are three types: <ul style="list-style-type: none"> <li>- Settlement through shares.</li> <li>- Settlement through cash.</li> <li>- With payment alternatives.</li> </ul>          | 3.1. |
| Grant date                     | The grant date is that on which the Group and the employees agree share-based payments whose characteristics are known to both.   | 3.2. |
| Accrual period                 | The period of time in which all the accrual conditions specified in a share-based payment transaction should be satisfied.  | 3.3. |
| Accrual conditions             | The conditions which must be satisfied by a third party to have the right to receive payment in cash or other capital instruments.  | 3.4. |
| <b>Recognition</b>             |   |      |
| Registry                       | The Group will recognise the corresponding increase in equity, in the case of share-based payments settled in equity instruments, or it will recognise a liability in case of cash settlement.  | 4.1. |
| Initial valuation              | The services received will be valued based on the fair value of the capital instruments delivered, which will be determined on the grant date.  | 4.2. |
| Subsequent valuation           | In the cases of plans whose settlement is in shares, the fair value is determined at the grant date and no subsequent changes in fair value are considered. Conversely, if the Group had cash settlement plans, the fair value would have to be calculated at each balance sheet date, recording changes in the fair value in the profit and loss account until settlement. | 4.3. |
| <b>Other aspects</b>           |   |      |
| Payments based on Group shares | A company must record share-based payments if its employees provide the service, regardless of who pays the   | 5.1. |

|  |  |      |
|--|--|------|
|  | transaction and independently of whether it is settled in cash or equity.  |      |
| Share-based payments with payment alternatives | <p>If the agreement establishes the possibility of the Group choosing between the payment being settled with delivery of equity instruments or in cash, said agreement will be accounted for:</p> <ul style="list-style-type: none"> <li>- As payment to settle in cash or other assets if the Group has incurred a commitment to settle in cash.</li> <li>- As payment to settle in shares if there is no such commitment.</li> </ul> | 5.2. |

### 3. Definitions

#### 3.1. Share-based payments

The delivery of shares of the company by its shareholders to employees are share-based payments, unless such delivery is not related to the provision of services by the employee.

There are three types of share-based payments depending on their settlement, thus, we can find:

- Share-based payments settled with equity instruments: in which case the Group provides equity instruments as consideration for the provision of services by its employees.
- Share-based payments settled in cash: in this case the settlement is made for amounts which are based on the price (or value) of the Group's shares.
- Share-based payments with payment alternatives: in this case, the Group provides the option of deciding whether to settle in cash or issuing equity instruments.

#### 3.2. Grant date

The grant date is that on which the Group and the employees agree share-based payments whose characteristics are known to both. On this date, the Group gives employees the right to obtain cash or an equity instrument in the event that certain parameters (accrual conditions) are met.

If the agreement requires approval, the grant date will be the date on which approval is obtained.

#### 3.3. Accrual period

The period of time in which all the accrual conditions specified in a share-based payment transaction should be satisfied.

#### 3.4. Accrual conditions

The conditions which must be satisfied by a third party to have the right to receive payment in cash or other capital instruments.

| Example conditions for accrual   |
|--|
| Provision of services during a certain period.                                     |
| Aspects related to the evolution of the company: share revaluation, minimum EBITDA |
| Fulfillment of objectives.   |

Sale of the company.

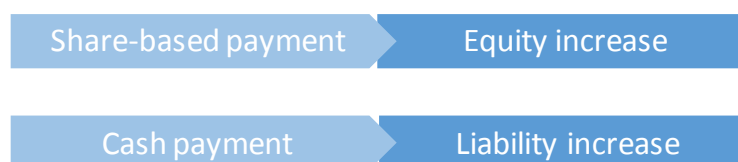
In this sense, at a Corporate Management level, the different conditions must be identified and analysed, as well as submitting them to the Standards Committee to assess the accounting impact.

## 4. Recognition

### 4.1. Registry

The Group will recognise the goods or services received or acquired in a share-based payment transaction at the time of receipt of services.

The Group will recognise the corresponding increase in equity, in the case of share-based payments settled in equity instruments, or it will recognise a liability in case of cash settlement. This is:



Since staff remuneration requires the counterparty (employees) to complete a number of years of service to receive the equity instruments, services and the corresponding increase in equity or liability as appropriate during the accrual period will be recognised, as the services are provided by employees.

In both cases, the services rendered by the staff will be recorded as expenses under the heading "Personnel expenses" in the profit and loss account.

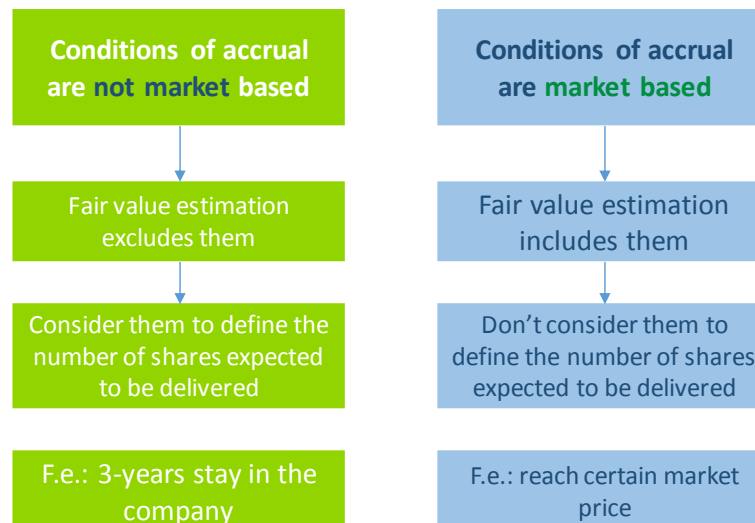
### 4.2. Initial valuation

The services received will be valued based on the **fair value** of the capital instruments delivered, which will be determined on the grant date.

The fair value will be determined taking the following aspects related to the conditions which concern it into account:

- Treatment of accrual conditions:
  - **Non-market** conditions: they will not be taken into account when estimating the fair value, although they will be taken into account, adjusting the number of equity instruments included in the determination of the amount of the transaction, so that, ultimately, the amount recognised for the service provided as consideration for the equity instruments granted will be based on the number of equity instruments which will eventually be consolidated, with this amount having to be revised. An example of such conditions is the granting of shares being subject to the employee having been employed by the Group for a certain number of years.
  - **Market** conditions: they will be taken into account when estimating the fair value of the equity instruments granted. An example of this would be to set a target price for the share.

In summary, the treatment of the accrual conditions on their inclusion in the fair value would be the following:



- Treatment of other conditions: should be taken into account when including it in the fair value, as they can be objectives based on the index of a listed raw material.

$$\text{Fair value} = \text{Market value} + \text{characteristics of the plan}$$

#### Example

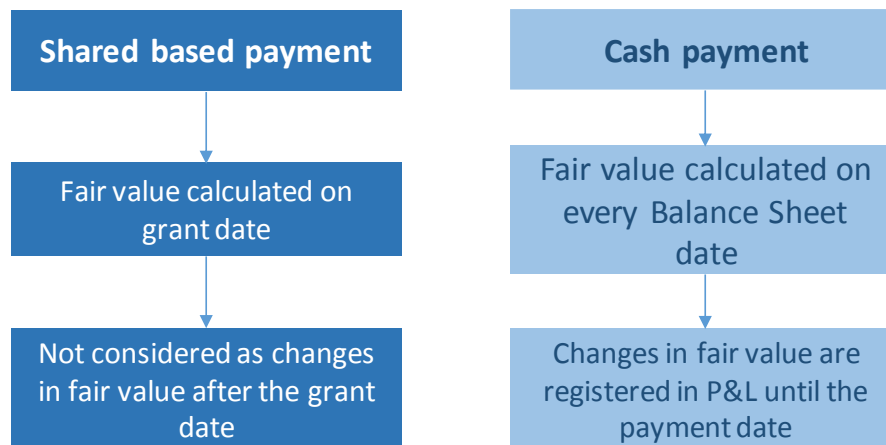
The Group's Incentive Plan sets the following conditions:

|                                  | Market conditions                                     | Non-market conditions  |
|----------------------------------|---|--|
| <b>Concept</b>                   | Share performance with respect to a determined index. | Time employed by the Group   |
| <b>Effect on the calculation</b> | Taken into account to assess the fair value.          | Taken into account to determine the number of shares delivered to each employee. |

### 4.3. Subsequent valuation

In the cases of plans whose settlement is in shares, the fair value is determined at the grant date and no subsequent changes in fair value are considered. Conversely, if the Group had cash settlement plans, the fair value would have to be calculated at each balance sheet date, recording changes in the fair value in the profit and loss account until settlement.

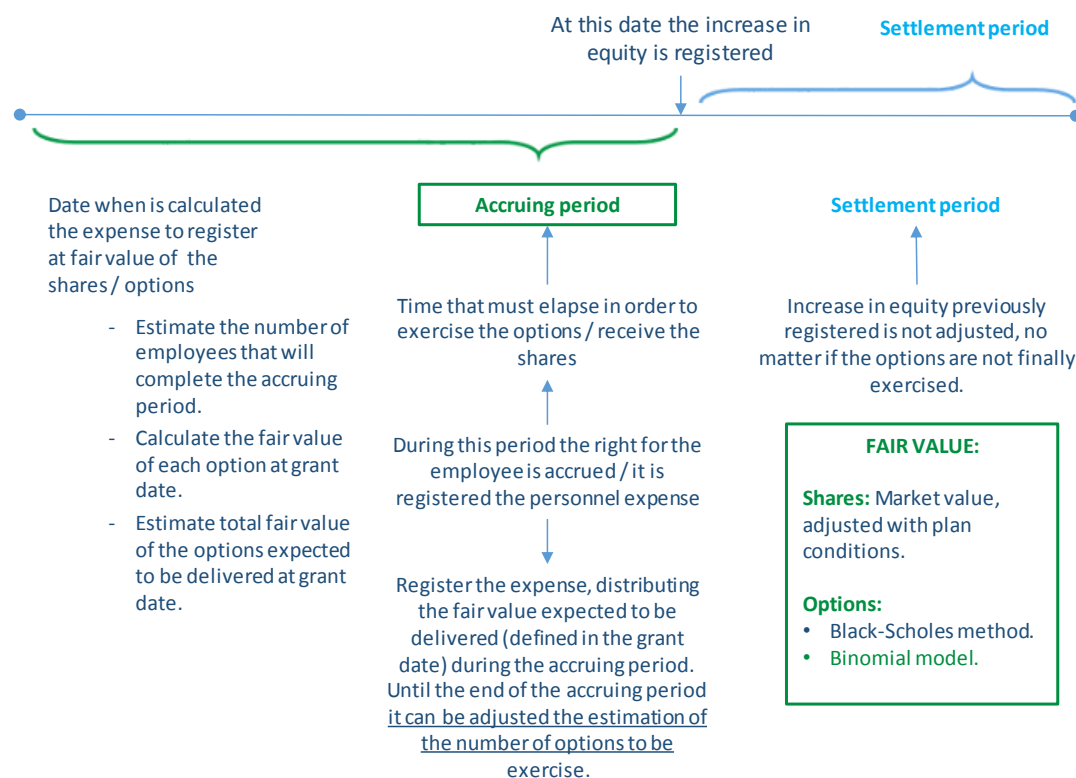
In short, the subsequent recognition according to the type of plan would be as follows:



In relation to the conditions discussed in section 4.2, regarding the accrual conditions, they will have the following effect on the profit and loss account:

|                              | Settlement in shares  | Settlement in cash  |
|------------------------------|---|---|
| <b>Market conditions</b>     | Without effect on the profit and loss account.  | Value changes with registry in the profit and loss account until settlement.                            |
| <b>Non-market conditions</b> | Its compliance is taken into account to adjust the amount of the transaction during the accrual period. | Its compliance is taken into account to adjust the amount of the transaction during the accrual period. |

In summary, the valuation from the grant date to settlement in the case of settlement in shares would be as follows:



## 5. Other aspects

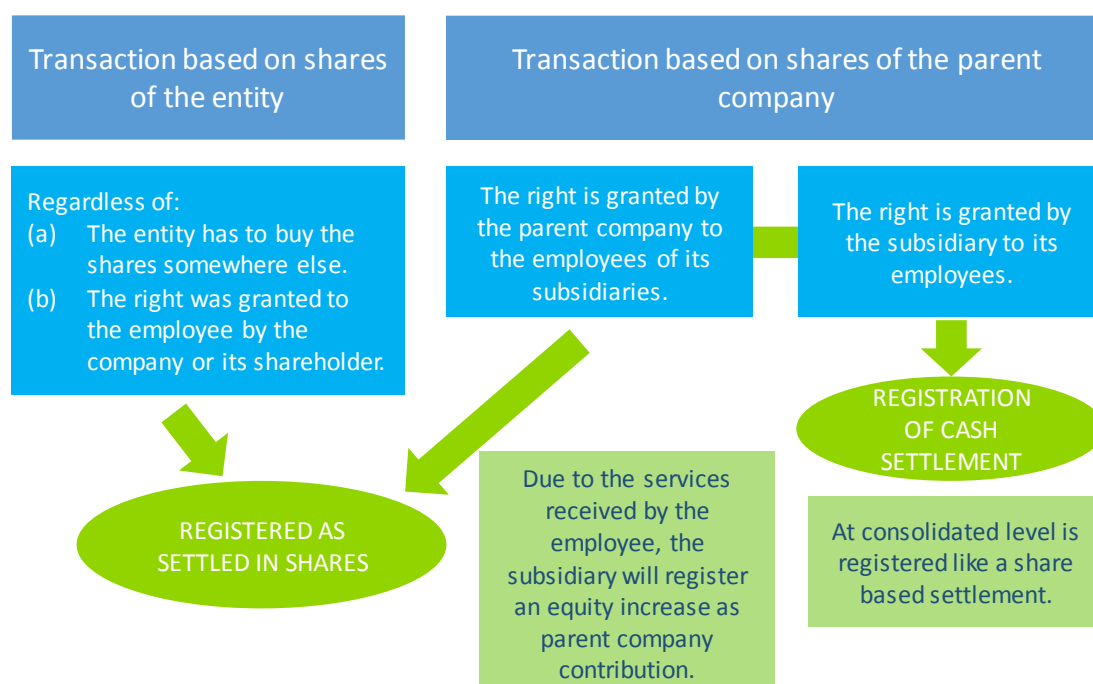
### 5.1. Payments based on Group shares

A company must record share-based payments if its employees provide the service, regardless of who pays the transaction and independently of whether it is settled in cash or equity.

Share-based payments settled through equity instruments will be recorded when:

- The incentives granted are its own equity instruments, or
- The entity has no obligation to settle the transaction with share-based payments.

This is:



### 5.2. Share-based payments with payment alternatives

If the agreement establishes the possibility of the Group choosing between the payment being settled with delivery of equity instruments or in cash, said agreement will be accounted for:

- As payment to settle in cash or other assets if the entity has incurred a commitment to settle in cash.
- As payment to settle in shares if there is no such commitment.

If the option is taken by the employee, the Group will value the fair value of the compound financial instrument at the grant date.

If the employee is indifferent to the alternatives, the fair value of the equity component is zero, all of which corresponds to debt. That is, the expense is recorded against a provision.



## 6. Example

The Group agrees a Plan **which is settled in shares** with the following characteristics:

- 500 employees take part in the share-based payments plan
- 100 options/employee
- Fair value/option: €15
- Accrual period: 3 years
- Price to be paid by the employee at the time of settlement: €0
- It is estimated that 20% of employees will leave before the end of the accrual period

1. Calculations to make on the grant date:

Total estimated fair value on grant date:  $15 \times 100 \times 400 (500 \times 80\%) = 600,000$

2. We distinguish between two situations:

a. Everything goes as estimated:

| Year | % leavers expected | Total Fair Value                                       | Cumulative Effect on Equity | Expense for the Year |
|------|--------------------|--|-----------------------------|----------------------|
| 1    | 20%                | $15 \times 100 \times 500 \times (1 - 20\%) = 600,000$ | $\times 1/3 = 200,000$      | 200,000              |
| 2    | 20%                | $15 \times 100 \times 500 \times (1 - 20\%) = 600,000$ | $\times 2/3 = 400,000$      | 200,000              |
| 3    | 20%                | $15 \times 100 \times 500 \times (1 - 20\%) = 600,000$ | $\times 3/3 = 600,000$      | 200,000              |
|      |                    |  |                             | <b>600,000</b>       |

The entries to make each year would be:

| Account | Description | Debit   | Credit  |
|---------|-------------|---------|---------|
| 6402    | Staff costs | 200,000 |         |
| 1190    | Equity      |         | 200,000 |

At the time of being exercised, there would be a reclassification between accounts of the "Equity" heading from 1190 to treasury stocks or share capital.

b. During the accrual period our estimate of the employees who will exercise the option varies:

| Year | % leavers expected | Total Fair Value   | Cumulative Effect on Equity | Expense for the Year |
|------|--------------------|--|-----------------------------|----------------------|
| 1    | 15%                | $15 \times 100 \times 500 \times (1 - 15\%) = 637,500$   | $\times 1/3 = 212,500$      | 212,500              |
| 2    | 12%                | $15 \times 100 \times 500 \times (1 - 12\%) = 660,000$   | $\times 2/3 = 440,000$      | 227,500              |
| 3    | 11.4%              | $15 \times 100 \times 500 \times (1 - 11.4\%) = 664,500$ | $\times 3/3 = 664,500$      | 224,500              |
|      |                    |  |                             | <b>664,500</b>       |

In this case, the entries to be performed would be equivalent to those in section a.

## **7. Related regulations**

1. Treasury shares. See module ["Treasury shares"](#)

# Accounting policy manual

## Foreign Currency Transactions

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Approved by:

SVP Consolidation and Internal  
Control

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## Foreign currency transactions

### 1. Scope

This accounting policy will be applicable to the conversion of transactions in a currency other than the functional currency of Grupo NH's Business Units (hereinafter "BU").

The accounting criteria under this policy are derived from the following international regulation:

| IAS / IFRS | Description  |
|------------|--|
| IAS 21     | Effect of exchange rate variations on foreign currency |

### 2. Executive Summary

| Area  | Concepts   | Ref. |
|---|--|------|
| <b>Further information about the definitions</b>                |  |      |
| Functional currency   | A company's functional currency is that of the main economic environment in which it operates. Said functional currency will be used to value assets, liabilities, equity, the company's income and expenses and all transactions in other currencies shall be foreign currency transactions.<br><br>The functional currency in Grupo NH is that of the country in which the company performs its activity (e.g. the euro for Spain and eurozone countries). | 3.1. |
| Foreign currency  | Any currency except the functional currency in each BU of Grupo NH   | 3.1. |
| Presentation currency   | Currency in which a company's financial statements are presented. This currency may be different from the functional currency.<br><br>The presentation currency of Grupo NH is the euro.   | 3.2. |
| <b>Conversion of foreign currency balances and transactions</b> |  |      |
| Exchange rate   | Relationship of the exchange between two currencies  | 4    |
| Foreign currency transactions                                   | A transaction in a foreign currency or whose settlement would be made in a foreign currency.   | 4.1. |
| Closing exchange rate   | Current exchange rate at the end of the reporting period   | 4.2. |
| Monetary item   | Those monetary units held in cash, as well as assets and liabilities to be received or paid through a fixed or determinable amount of monetary units   | 4.2. |
| Non-monetary item   | All those items which do not meet the characteristics to be considered as monetary   | 4.2. |

### **3. Further information about the definitions**

#### **3.1. Functional currency**

A company's functional currency is that of the main economic environment in which it operates. Said functional currency will be used to value assets, liabilities, equity, the company's income and expenses and all transactions in other currencies shall be foreign currency transactions.

In general, each Grupo NH business has its own functional currency; the functional currency of the Group is the euro.

To determine the appropriate functional currency, emphasis should be placed on the currency which determines the setting of prices of transactions undertaken, rather than the currency in which these transaction are denominated. The following main factors should be considered to determine the appropriate functional currency:

- The currency which fundamentally influences the sales prices of goods and services; this will often be the currency in which sales prices are denominated.
- The currency of a country whose competitive forces and regulations primarily determine the sales prices of its goods and services.
- The currency which mainly influences labour costs, materials and other costs to supply goods and services; this will often be the currency in which said costs are denominated and settled.

These are the main factors to consider. However, there are an additional two indicators which are:

- The currency in which funds for financing activities are generated. This would be the currency corresponding to the equity and debt instruments issued.
- The currency in which payments for operational activities are received.

As a general rule in Grupo NH, the functional currency will be that of the country in which the BU performs its activity.

If there is a change in the functional currency of the BU, it will, from the date of the change, prospectively apply the conversion procedures which are applicable to the new functional currency.

#### **3.2. Presentation currency**

Although the BU values items in its financial statements in its functional currency, it can decide to present its financial statements in a currency or currencies other than the functional currency.

It should use the same presentation currency for all years presented and, in the case of a change in presentation currency, the comparative information should be converted to present a third balance sheet at the beginning of the first year where such information is considered relevant.

#### **3.3. Foreign currency**

Any currency other than the functional currency.

### **4. Conversion of foreign currency balances and transactions**

The conversion of foreign currency balances and transactions occurs when a company carries out transactions (purchases, sales and other transactions) in a foreign currency. For example, in the case of companies which make purchases in USD when the functional currency is the EURO.

This conversion should be done locally in each BU of Grupo NH when transactions are made in a currency other than the functional currency of the country.

In summary, the exchange rates applicable in the conversion of foreign currency to functional currency are as follows:

|   |   |
|---|---|
| <b>Initial recognition:</b>                     | Exchange rate in force between the functional currency and the foreign currency on the transaction date |
| <b>At the date of the financial statements:</b> |   |
| Balance sheet                                   |   |
| • Monetary items                                | → Closing rate  |
| • Non-monetary items                            | → Currency rate on the date of initial recognition ( <b>historic cost</b> of the transaction)           |
| Profit and loss account                         |   |
| • All items                                     | → On the transaction date   |

The conversion criteria are as follows:

#### 4.1. Conversion on the transaction date

Each foreign currency transaction will be recorded in the company's functional currency at the average monthly exchange rate.

The exchange rates to be applied by each BU of Grupo NH for each currency other than its functional currency shall be the daily exchange rates established in the corporate exchange rate master.

##### Example

A BU of Grupo NH whose functional currency is FuncC purchases office material amounting to 4,000 ForC (foreign currency other than its functional currency)

- Suppose that the daily exchange rate established by the group master for this day is 0.75 FuncC for each ForC, the entry which this BU should register on the transaction date should be:

| Account | Description                                | Debit | Credit |
|---------|--|-------|--------|
| 628     | Office material                            | 3,000 |        |
| 400     | Suppliers                                  |       |        |
|         | Amount paid: 4,000 ForC * 0.75=3,000 FuncC |       | 3,000  |

- Suppose that the transaction is paid 15 days later and that there is no monthly close between both dates and that the exchange rate on the date of payment is 0.8, so that 3,200 FuncC should be paid instead of the 3,000 registered on the purchase date; the BU should record the following entry:

| Account | Description                                 | Debit | Credit |
|---------|---|-------|--------|
| 400     | Suppliers                                   | 3,000 |        |
| 668     | Realised negative exchange rate differences | 200   |        |
| 5700    | Cash  |       |        |
|         | Amount paid: 4,000 ForC * 0.8=3,200 FuncC   |       | 3,200  |

## 4.2. Conversion on the presentation date

### 4.2.1. Monetary items

At the presentation date of the financial statements, monetary items denominated in a currency other than the functional currency of the company are converted at the exchange rate of that date (closing rate). In addition, in general terms, in the BU of Grupo NH, only cash accounts will be considered as monetary items in addition to accounts receivable or payable regardless of their maturity.

### 4.2.2. Non-monetary items

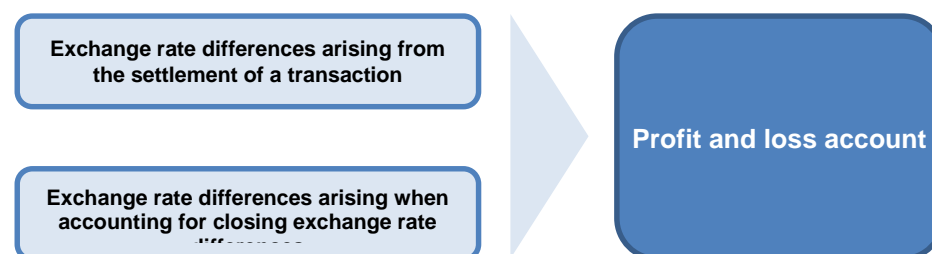
Non-monetary items are always valued at historic cost and will not be converted again at the presentation date, remaining therefore valued at the exchange rate in force on the transaction date.

In the case of Group NH, as a general criterion, all items other than those listed in section 4.2.1 of this policy will be considered non-monetary items, i.e. the amounts paid in advance for goods and services (e.g. anticipated lease payments); capital gain; intangible assets; inventories; property, plant and equipment; supplies settled through delivery of a non-monetary asset.

### 4.2.3. Recognition of results from foreign currency exchange rate differences

Positive and negative results from foreign currency exchange rate differences are generally recognised in profit/(loss) for the period, as described in earlier sections of this policy. The only exceptions to this criterion are related to monetary items which essentially form part of the net investment in an overseas business, as well as the hedging instruments in a cash flow hedge which meets the conditions to be considered as such, or the hedge of a net investment in a foreign business, contemplated in IAS 39 "Financial Instruments: Recognition and Measurement".

Thus, accounting for exchange rate differences:



## 5. Other related standards

1. Dealing with Consolidated and individual cash flow statements. See module ["Consolidated and individual cash flow statements"](#)
2. Dealing with hyperinflation. See module ["Hyperinflation"](#)

## 6. Practical example

The following example is offered for illustrative effects to show the most frequent accounting entries in the accounts of the module:

### 1. Example 1:



On 1 August 20X0, Grupo NH, whose functional currency is FuncC, acquires amenities amounting to 10,000 FuncC. The exchange rate of the foreign currency on this date is 1.3 FuncC/ForC. The operation expires in 30 days.

## Initial recognition

### Accounting entry:

On 1 August X1, account for the debt with suppliers at the exchange rate on that date, which gives the following record:

| Account | Description   | Debit  | Credit |
|---------|---|--------|--------|
| 600     | Merchandise purchased   | 13,000 |        |
| 400     | Suppliers, foreign currency<br><i>Amount paid: 10,000 ForC * 1.3=13,000 FuncC</i> |        | 13,000 |

## Subsequent recognition

On 1 September 20X0, the transaction matures, the exchange rate now is 1.25 FuncC/ForC. As it is a debt, the cost of the required ForC is lower than that initially set, so positive differences will arise, which when made will be carried to results. The entry will be:

| Account | Description   | Debit  | Credit |
|---------|---|--------|--------|
| 400     | Suppliers, foreign currency<br><i>Amount paid: 10,000 ForC * 1.3=13,000 FuncC</i> | 13,000 |        |
| 768     | Realised positive exchange rate differences                                       |        | 500    |
| 572     | Banks<br><i>Amount paid: 10,000 ForC * 1.25=12,500 FuncC</i>                      |        | 12,500 |

## 2. Example 2:

A BU of Grupo NH has the local model (LM) as its functional and presentation currency. During the year N has carried out a series of transactions in foreign currency (ForC), which have led to the year-end date having the following monetary items denominated in ForC and which were accounted for as follows at the time of the transaction:

| Item                               | Amount in ForC | Amount in LM on the transaction date |
|------------------------------------|----------------|--------------------------------------|
| Account payable to supplier A      | (100,000)      | (120,000)                            |
| Account payable to supplier B      | (30,000)       | (39,000)                             |
| Account receivable from customer C | 200,000        | 300,000                              |
| Account receivable from customer D | 150,000        | 180,000                              |

If we suppose that the closing exchange rate reaches 1.3 LM for each ForC, the BU should perform the following conversion process:

| Item                               | Amount in ForC | Amount in LM on the transaction date | Amount in LM on the closing date | Exchange rate difference |
|------------------------------------|----------------|--------------------------------------|----------------------------------|--------------------------|
| Account payable to supplier A      | (100,000)      | (120,000)                            | (130,000)                        | (10,000)                 |
| Account payable to supplier B      | (30,000)       | (39,000)                             | (39,000)                         | 0                        |
| Account receivable from customer C | 200,000        | 300,000                              | 260,000                          | (40,000)                 |
| Account receivable from customer D | 150,000        | 180,000                              | 195,000                          | 15,000                   |

Therefore, on the closing date, the following entries would be recorded:

a) Regarding the items payable:

| Account | Description   | Debit  | Credit |
|---------|---|--------|--------|
| 668     | Unrealised negative exchange rate differences (suppliers)   | 10,000 |        |
| 400     | Suppliers, foreign currency<br>For exchange rate differences in supplier A, given that B has no differences |        | 10,000 |

b) Regarding the items receivable:

| Account | Description   | Debit  | Credit |
|---------|---|--------|--------|
| 668     | Unrealised negative exchange rate differences (customers)<br>For customer C | 40,000 |        |
| 768     | Unrealised positive exchange rate differences (customers)<br>For customer D |        | 15,000 |
| 430     | Customers<br>For the exchange rate differences on customers                 |        | 25,000 |

### 3. Example 3:

A BU has acquired a fixed asset in a currency other than the functional currency (ForC) for 200,000 ForC. The exchange rate on the transaction date is 1.1 FuncC for each ForC and the closing exchange rate reaches 1.3. Here, the fixed asset will be recorded on the balance sheet converted to FuncC with the exchange rate on the transaction date:

#### Initial recognition

Accounting entry:

| Account | Description  | Debit   | Credit  |
|---------|--|---------|---------|
| 62X     | Property, plant and equipment                              | 220,000 |         |
| 400     | Suppliers<br>Amount paid: 200,000 ForC * 1.1=220,000 FuncC |         | 220,000 |

#### Subsequent recognition

At the closing date, the valuation of the fixed asset will not be changed, even if the suppliers' figure does where it has not yet been paid, being treated as a monetary item as opposed to a fixed asset.

| Account | Description  | Debit  | Credit |
|---------|--|--------|--------|
| 468     | Unrealised negative exchange rate differences (suppliers)                                  | 40,000 |        |
| 400     | Suppliers<br>Amount paid: $(200,000 \text{ ForC} * 1.3 = 260,000 \text{ FuncC}) - 220,000$ |        | 40,000 |

#### 4. Example 4:

A BU of subgroup "A" has functional currency FuncCA, which in turn is the presentation currency of Grupo NH to which it belongs. This BU grants a loan to another BU of subgroup "B" whose functional currency is FuncCB.

The loan amount is 100,000 FuncCA which B converts to FuncCB at the time it receives it at the transaction date exchange rate, which amounts to 1.5 FuncCB for each FuncCA. Therefore, the items which each BU would register at the time of delivery would be:

#### Initial recognition

a) BU of subgroup "A":

| Account | Description                          | Debit   | Credit  |
|---------|--------------------------------------|---------|---------|
| 534     | S/T Loans granted to Group Companies | 100,000 |         |
| 572     | Banks                                |         | 100,000 |

b) BU of subgroup "B":

| Account | Description   | Debit   | Credit  |
|---------|---|---------|---------|
| 572     | Banks   | 150,000 |         |
| 534     | S/T Loans with Group Companies<br>Amount: $100,000 \text{ FuncCA} * 1.5 = 150,000 \text{ FuncCB}$ |         | 150,000 |

#### Subsequent recognition

If the exchange rate on the closing date was 1.4, the BU of subgroup "A" would not make any entry but the BU of subgroup "B" would have to include the effect of the changes in the exchange rate of the account payable, in this case it would record the following entry:

| Account | Description  | Debit  | Credit |
|---------|--|--------|--------|
| 510     | S/T Loans with Group Companies   | 10,000 |        |
| 568     | Unrealised positive exchange rate differences (suppliers)<br>Amount: $(100,000 \text{ FuncCA} * 1.4 = 140,000 \text{ FuncCB}) - 150,000$ |        | 10,000 |

# Accounting policy manual

## Hyperinflation

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Approved by:

SVP Consolidation and  
Internal Control

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## Hyperinflation

### 1. Scope

This accounting policy applies to the Business Units of Grupo NH in countries with hyperinflationary economies. Should any BU restate its financial statements because it is in an economy with high inflation rates, it must obtain the approval of Grupo NH's Accounting Policy Director.

The accounting criteria under this policy are derived from the following international regulation:

| IAS / IFRS | Description  |
|------------|--|
| IAS 29     | Financial Reporting in Hyperinflationary Economies |

### 2. Executive Summary

| Area   | Concepts   | Ref.   |
|--|--|--------|
| <b>Hyperinflation indicators</b>                               |  |        |
| Hyperinflation   | The financial statements of an entity whose functional currency is hyperinflationary should be adjusted to express all items in terms of the current unit of measure on the information's presentation date, i.e. the concept of current purchasing power should be adopted.   | 3      |
| <b>Measuring the hyperinflation rate</b>                       |  |        |
| Appropriate price index  | According to Grupo NH policy, CPI is the most appropriate index for assessing the inflation rate since it is in widespread use for all consumers in an economy.  | 4.1.   |
| Cumulative inflation rate                                      | According to Grupo NH policy, a compound inflation rate should be calculated.  | 4.2.   |
| <b>Restatement of financial statements</b>                     |  |        |
| Statement of financial position at the beginning of the period | Monetary and non-monetary items are indexed upwards to reflect their current purchasing power at the end of the period.<br>Non-monetary items may have been acquired many periods ago when the purchasing power of the currency was higher. The historical amounts of the currencies will have to be indexed upwards from the acquisition date to the purchasing power rate at the end of the period.<br>Monetary items are always, at a given date, the current purchasing power at that date. Therefore, the monetary items included in the opening statement of financial position should be indexed upwards, that is, their opening balance is increased to reflect the fact that the asset has a higher purchasing power, up to the purchasing power in force at the close of the period. | 5.1.1. |
| Statement of financial position at the close of the period     | The closing statement of financial position is also indexed upwards based on current purchasing power.<br>Since monetary items always reflect, at a given date, the purchasing power at that date, the monetary units held at the end of the period do not need to be adjusted.  | 5.1.2. |

|   |  |        |
|---|--|--------|
|   | Non-monetary items are based on purchasing power at the end of the period and, therefore, assuming no change in non-monetary items in the period, are accounted for at the same amount as in the adjusted opening statement of financial position.<br>On the other hand, a non-monetary asset acquired during the year is indexed upwards from the purchasing power on the purchase date to the purchasing power at the end of the period. |        |
| Statement of comprehensive income for the period      | A hyperinflationary statement of comprehensive income includes two components, the gain or loss derived from holding monetary assets or liabilities, and the gain or loss derived from the transactions made during the period.  | 5.1.3. |
| Comparative figures                                   | The comparative figures are calculated by taking the comparative figures for the end of the previous period and applying a general price index so that they are presented in terms of the current measurement unit at the end of the current period. The same process is used to calculate the comparative figures used to calculate the opening statement of financial position.  | 5.2.   |
| <b>First application of hyperinflation accounting</b> |  |        |
| First application of hyperinflation accounting        | When a company identifies that the economy of its functional currency is hyperinflationary, it applies the provisions of this policy retroactively, as if the economy had always been hyperinflationary.   | 6      |
| <b>Economies which cease being hyperinflationary</b>  |  |        |
| Economies which cease being hyperinflationary         | When an economy ceases to be hyperinflationary, the Group's company shall cease to prepare and present these financial statements prepared in accordance with the provisions of this policy from annual periods ending on or after the date this circumstance occurred.  | 7      |

### 3. Hyperinflation indicators

When the functional currency of an entity is hyperinflationary its financial statements should be adjusted to express all items in terms of the current unit of measure on the information's presentation date, i.e. the concept of current purchasing power should be adopted.

According to international regulations, it is a matter of judgement when restatement for hyperinflation is necessary. Thus, hyperinflation is identified by the characteristics of an economy, including the following:

- The cumulative inflation rate over three years is approaching, or exceeds, 100%
- The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. In addition, amounts of local currency held are immediately invested to maintain purchasing power.
- Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.

- The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.
- Interest rates, wages and prices are linked to a price index.

It should be noted that although 100% is a key factor in identifying hyperinflation, it is not the only one and should not be considered in isolation. Applying all these factors could result in a country being considered hyperinflationary when the cumulative inflation rate in three years is, for example, only 80%. Also, although the judgement of value is a determinant when establishing the beginning of hyperinflation, the standard expresses its preference in the sense that all the entities of the same country affected by high inflation rates apply the standard from the same date .

Restatement for hyperinflation is not optional. For example, the standard cannot be adopted when an entity believes that the cumulative effect of inflation is significant and, consequently, that restatement would be beneficial.

## 4. Measuring the hyperinflation rate

### 4.1. Appropriate price index

There are two main indices which are generally used in the measurement of the general inflation rate in most countries:

- The Consumer Price Index (CPI) measures the change in the cost of a basket of goods and services consumed by a "typical household", usually including housing, electricity, food and transportation.
- The Producer or Wholesale Price Indices (PPI or WPI) measure wholesale price levels.

The standard requires the use of a general price index which reflects the changes in the general purchasing power.

According to Group policy, CPI is the most appropriate index for assessing the inflation rate since it is in widespread use for all consumers in an economy.

### 4.2. Cumulative inflation rate

The standard refers to the cumulative inflation rate, but does not specify whether it is calculated on a simple or compound basis.

Thus, if the inflation rate in three consecutive years is 20, 30 and 40 per cent, respectively, the cumulative simple inflation rate and the composite inflation rate would be as follows:

- Simple cumulative inflation rate: **90 per cent** (20+30+40)
- Compound inflation rate: **118 per cent**, given that:
  - o At the start of year 1, an index of 100 is assumed.
  - o At the end of year 1, the index is 120 (100x1.2).
  - o At the end of year 2, the index is 156 (120x1.3).
  - o At the end of year 3, the index is 218 (156x1.4), giving a cumulative rate of 118 per cent (218-100).



According to Grupo NH policy, a compound inflation rate should be calculated, since the simple rate would be obtained as an aggregation of the annual indices without considering the cumulative outlook of the three-year computation period.

## 5. Restatement of financial statements

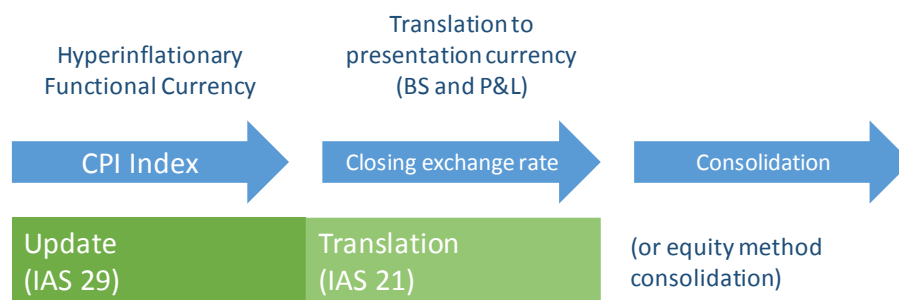
### 5.1. General criterion

To prepare a statement of financial position and an overall statement of income in a hyperinflationary economy, it will be necessary to restate their comparative figures and determine the impact of changes in purchasing power. In order to prepare these statements, it requires a restatement of:

- The statement of financial position at the beginning of the period;
- The statement of financial position at the close of the period;
- The statement of comprehensive income for the period.

In addition, the changes will also affect the statement of changes in equity and the cash flow statement.

In the foreign entities of a hyperinflationary economy the following scheme will be followed regarding the regulation and the interest rate or index to be applied according to the nature of change:



#### 5.1.1. Statement of financial position at the beginning of the period

Statement of financial position amounts not already expressed in terms of the measuring unit current at the end of the reporting period are restated by applying a general price index, i.e. indexed upwards to reflect its current purchasing power at the end of the period.

Monetary items are not restated because they are already expressed in terms of the monetary unit current at the end of the reporting period. The historical amounts will have to be indexed upwards from the acquisition date to the purchasing power rate at the end of the period. Monetary items are money held and items to be received or paid in money.

All other assets and liabilities are non-monetary. Some non-monetary items are carried at amounts current at the end of the reporting period, such as net realisable value and market value, so they are not restated. All other non-monetary assets and liabilities are restated.

#### 5.1.2. Statement of financial position at the close of the period

The closing statement of financial position is also indexed upwards based on current purchasing power.

Since monetary items always reflect, at a given date, the purchasing power at that date, the monetary units held at the end of the period do not need to be adjusted.

On the other hand, non-monetary items are based on purchasing power at the end of the period and, therefore, assuming no change in non-monetary items in the period, are accounted for at the same amount as in the adjusted opening statement of financial position. Also, a non-monetary asset acquired during the year is indexed upwards from the purchasing power on the purchase date to the purchasing power at the end of the period.

### 5.1.3. Statement of comprehensive income for the period

A hyperinflationary statement of comprehensive income includes two components, the gain or loss derived from holding monetary assets or liabilities, and the gain or loss derived from the transactions made during the period.

All income accrued or expenses incurred during the period should be indexed upwards from the initial accounting date to reflect the existing purchasing power at the end of the period. For practical reasons, an average rate of indexation could be accepted when the overall result is not materially different from the result which would have been obtained by indexing individual income and expense items according to the date on which the transaction was made.

#### Example

Suppose that a BU of Grupo NH maintains 1,000 CU of cash (and 1,000 of share capital) and has no more assets, liabilities or transactions during a year in which the CPI has increased from 100 to 150. The BU has suffered economic loss, and accounting for current purchasing power forces it to be shown in the financial statements. The BU would need 1,500 CU of cash at year-end to maintain the same purchasing power position as the 1,000 CU of cash at the beginning of the year, so it has actually had an economic loss of 500.

The following example illustrates the process:

|                                     |     |
|-------------------------------------|-----|
| - Index at close of N-2             | 100 |
| - Index at close of N-1             | 150 |
| - Index at end of October of year N | 180 |
| - Index at close of year N          | 200 |
| - Average index during year N       | 175 |

#### Statement of financial position before hyperinflation adjustments:

|   | Year N Historical<br>Purchasing Power | Year N-1 Historical<br>Purchasing Power |
|---|---------------------------------------|---|
| Share capital (contributed at the close of N-2) | 100                                   | 100                                     |
| Retained Earnings                               | 1,050                                 | 800                                     |
| <b>TOTAL EQUITY</b>                             | <b>1,150</b>                          | <b>900</b>                              |
|   |                                       |   |
| Land (acquired at close of N-1)                 | 600                                   | 600                                     |
| Shares held for trading                         | 250                                   | 150                                     |

|   |              |            |
|---|--------------|------------|
| Inventories (acquired at the end of October of N) | 100          | -          |
| Trade receivables                                 | 500          | 200        |
| Cash  | 100          | 350        |
| Loan payable                                      | (400)        | (400)      |
| <b>NET ASSETS</b>                                 | <b>1,150</b> | <b>900</b> |

**Statement of overall income before hyperinflation adjustments:**

|  | <b>N</b>   |
|--|------------|
| Ordinary income                                | 1,150      |
| Gains from changes in fair value of the shares | 100        |
| Finance costs                                  | (100)      |
| Trade receivables                              | (900)      |
| <b>TOTAL</b>                                   | <b>250</b> |

In preparing the financial statements for year N, the opening statement of financial position is adjusted so as to be expressed in the current measurement unit at the date of presentation of the information, i.e. at the close of year N.

They can be prepared in two ways:

- From the historical opening statement of financial position (using indices from the acquisition date or non-monetary items and dividing the balance of the monetary items by the index at the close of the comparative year and then multiplying it by the index at the end of the current period).
- From the indexed statement of financial position of the previous period (in which case, all assets and liabilities included in the closing statement of financial position of the previous period are divided by the index at the close of N-1 of 150 and multiplied by the index at the close of N of 200). The example is illustrated below:

**Opening statement of financial position:**

|   | <b>Year N-1<br/>Historical Amount</b> | <b>End of Year N-1<br/>Accounted for in<br/>the Previous<br/>Period<sup>1</sup></b> | <b>Opening of Year<br/>N-1<br/>Adjusted<sup>2</sup></b> |
|---|---------------------------------------|---|---|
| Share capital (contributed at the close of N-2)   | 100                                   | 150   | 200   |
| Retained Earnings                                 | 800                                   | 750   | 1,000   |
| <b>TOTAL EQUITY</b>                               | <b>900</b>                            | <b>900</b>  | <b>1,200</b>  |
|   |                                       |   |   |
| Land (acquired at close of N-1)                   | 600                                   | 600   | 800   |
| Shares held for trading                           | 150                                   | 150   | 200   |
| Inventories (acquired at the end of October of N) | -                                     | -   | -   |
| Trade receivables                                 | 200                                   | 200   | 267   |
| Cash  | 350                                   | 350   | 467   |

|                   |            |            |              |
|-------------------|------------|------------|--------------|
| Loan payable      | (400)      | (400)      | (534)        |
| <b>NET ASSETS</b> | <b>900</b> | <b>900</b> | <b>1,200</b> |

Notes:

- (1) As shown in the N-1 hyperinflationary financial statements  
(2) According to the restatement for inclusion as comparative figures/opening position in the financial statements of N.

In general, non-monetary items are adjusted from their acquisition or contribution date.

**Closing statement of financial position:**

|   | <b>N</b> Historical | <b>N</b> Adjusted  |
|---|---------------------|--------------------|
| Share capital (contributed at the close of N-2)   | 100                 | 200 <sup>1</sup>   |
| Retained Earnings                                 | 1,050               | 1,161 <sup>2</sup> |
| <b>TOTAL EQUITY</b>                               | <b>1,150</b>        | <b>1,361</b>       |
|   |                     |                    |
| Land (acquired at close of N-1)                   | 600                 | 800 <sup>3</sup>   |
| Shares held for trading                           | 250                 | 250                |
| Inventories (acquired at the end of October of N) | 100                 | 111 <sup>4</sup>   |
| Trade receivables                                 | 500                 | 500                |
| Cash  | 100                 | 100                |
| Loan payable                                      | (400)               | (400)              |
| <b>NET ASSETS</b>                                 | <b>1,150</b>        | <b>1,361</b>       |

Notes:

- (1) Share capital contributed in N-2, calculated using the N-2 closing index as follows:  $(200/100) \times 100$   
(2) Retained earnings have been obtained from other amounts in the statement of financial position, the increase reflects the increase in profits during the year (228) less the monetary loss (117)  
(3) Land acquired at the end of N-1, calculated using the N-1 closing index as follows:  $(200/150) \times 600$   
(4) Inventories acquired in October of N, calculated using the October index for N as follows:  $(200/180) \times 100$

Revenues and expenses accounted for in the statement of comprehensive income are restated to reflect changes in the price index from the date they were initially recorded in the financial statements. In this example, an average index is applied. In practice, a single annual average rate may not be adequate depending on the evolution of the hyperinflationary economy's indices.

|   | <b>N</b> Historical | <b>N</b> Adjusted         |
|---|---------------------|---------------------------|
| Ordinary income                           | 1,200               | 1,371 <sup>1</sup>        |
| Expenses                                  | (1,000)             | (1,143) <sup>2</sup>      |
| <b>NET PROFIT</b>                         | <b>200</b>          | <b>228</b>                |
|   |                     |                           |
| Losses derived from net monetary position | -                   | (117) <sup>3</sup>        |
| <b>TOTAL NET PROFIT/(LOSS)</b>            | <b>200</b>          | <b>111<sup>4, 5</sup></b> |

Notes:

- (1) Ordinary income calculated using an average index for N as follows:  $200/175 \times 1,200$
- (2) Expenses calculated using an average index for N as follows:  $200/175 \times 1,000$
- (3) The calculation of the loss on a net monetary position is explained in section 5.1.3 and calculated in the following table
- (4) Total net profit can also be calculated as a change in adjusted retained earnings ( $1,111 - 1,000$ )
- (5) This example supposes that all ordinary income and expenses are monetary transactions (i.e. there is no amortisation, remediation of inventories, etc.)

The loss or gain on a net monetary position can be estimated applying the change in the general price index to the weighted average difference for the period between monetary assets and liabilities. Alternatively, it can also be obtained as the difference resulting from the restatement of non-monetary assets and equity. The loss on the net monetary position recognised in the financial statements of year N in the example is determined as follows:

**Losses derived from net monetary position:**

|   | <b>N<br/>Adjusted<br/>Opening<br/>Balance</b> | <b>N<br/>Transactions<br/>in Adjusted<br/>Profit/(Loss)</b> | <b>N<br/>Transactions<br/>in Adjusted<br/>Balance Sheet</b> | <b>N<br/>Monetary<br/>Loss</b> | <b>N<br/>Adjusted<br/>Closing<br/>Balance</b> |
|---|---|---|---|--------------------------------|---|
| Share capital<br>(contributed at the<br>close of N-2) | 200   | -   | -   | -                              | 200   |
| Retained Earnings                                     | 1,000   | 228   | -   | (117)                          | 1,111   |
| <b>TOTAL EQUITY</b>                                   | <b>1,200</b>                                  | <b>228</b>  | <b>-</b>  | <b>(117)</b>                   | <b>1,311</b>                                  |
|   |   |   |   |                                |   |
| Land  | 800   | -   | 111   | -                              | 911   |
| Inventories   | -   | -   | -   | -                              | -   |
| Investments   | 200   | -   | -   | -                              | 200   |
| Trade receivables                                     | 267   | 171   | -   | 62                             | 500   |
| Cash  | 467   | 57  | (111)   | (313)                          | 100   |
| Loan payable  | (534)   | -   | -   | 134                            | (400)   |
| <b>NET ASSETS</b>                                     | <b>1,200</b>                                  | <b>228</b>  | <b>-</b>  | <b>(117)</b>                   | <b>1,311</b>                                  |

## 5.2. Comparative figures

The comparative figures are calculated by taking the comparative figures for the end of the previous period and applying a general price index so that they are presented in terms of the current measurement unit at the end of the current period. The same process is used to calculate the comparative figures used to calculate the opening statement of financial position.

Any other information offered in relation to previous years will also be expressed in terms of the current measurement unit at the closing date of the reporting period.

## 6. First application of hyperinflation accounting

When a company identifies that the economy of its functional currency is hyperinflationary, it will apply the provisions of this policy retroactively, i.e., as if the

economy had always been hyperinflationary. Non-monetary assets and liabilities at the end of the current period, those at the beginning of the current period and those at the beginning of the comparative period will all be restated according to changes in prices from the date on which they were acquired or incurred to the purchasing power at the closing date of the current period. The monetary items at the beginning of the comparative and current periods will be restated from those dates to the purchasing power at the end of the current period.

## **7. Economies which cease being hyperinflationary**

When an economy ceases to be hyperinflationary, the Grupo NH company shall cease to prepare and present these financial statements prepared in accordance with the provisions of this policy from annual periods ending on or after the date this circumstance occurred.

When the hyperinflation accounting is no longer applied, the Grupo NH Accounting Policy Director will be informed and authorisation obtained as soon as possible (as soon as the indicators mentioned in section 3 recommend discontinuing their application).

## **8. Other related standards**

1. Dealing with Foreign currency transactions See module ["Foreign currency transactions"](#)
2. Dealing with Consolidated and individual cash flow statements See module ["Consolidated and individual cash flow statements"](#)



# Accounting policy manual

## Recognition of income

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SVP Consolidation and Internal  
Control

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## Recognition of income

### 1. Scope

This accounting policy will be applicable to the recognition and valuation of the income from the sale of goods and the rendering of services generated by Grupo NH Companies for the different concepts, from the point of view of the group. Consequently, the following transactions fall within the scope of this policy:

- Accommodation
- Rooms
- Restaurant and other F&B
- Levies on management, use of brand, etc.
- Agency commissions

The accounting criteria under this policy are derived from the following international regulation:

| IAS / IFRS | Description                        |
|------------|------------------------------------|
| IAS 18     | Revenue from ordinary activities   |
| IFRIC 13   | Customer loyalty programmes        |
| IFRIC 18   | Transfers of assets from customers |

### 2. Executive Summary

| Area                                | Concepts   | Ref. |
|-------------------------------------|--|------|
| <b>General recognition criteria</b> |  |      |
| Recognition                         | Ordinary income is only recognised if it is probable that the entity will obtain future economic benefits, and these can be estimated reliably.  | 3    |
| Provision of services               | The main activity of Grupo NH Hoteles is the provision of services. Income from ordinary activities is recognised considering the degree of completion of the final benefit of the reporting period, according to its accrual. A transaction's degree of completion is determined to the extent of which the services have been executed to date as a percentage of the total services to be provided. | 3.1. |
| Sale of goods                       | The sale of goods is recognised when the company transfers the significant risks and advantages inherent in the ownership of the goods to the purchaser. In the case of Grupo NH Hoteles, the accrual will occur at the moment the goods are delivered to the customer.  | 3.2. |
| Valuation of income                 | Ordinary income is valued at the fair value of the consideration received or to be received from it, an amount which coincides with the retail price paid by the customer.   | 3.3. |

| Typology of Grupo NH income |  |      |
|-----------------------------|--|------|
| Hotel occupancy             | Ordinary income from hotel occupancy will be recognised at the time of accrual of the provision of the service to the customer.  | 4.1. |
| Other services              | Ordinary income from restaurants, spa, golf, etc. will be recognised at the time of accrual of the provision of the service to the customer.   | 4.2. |
| Rooms                       | Ordinary income from the hire of rooms will be recognised at the time of accrual of the provision of the service to the customer.  | 4.3. |
| Levies                      | Ordinary income from levies charged to hotels operated under management and services provided by Grupo NH Hoteles to third parties, will be recognised at the time of accrual of the provision of the service to the customer. | 4.4. |
| Other aspects to consider   |  |      |
| NH World                    | The Group will record a liability for the acquisition of credits from its loyalty programmes which will be recorded as income at the time of redemption,   | 5.1. |
| Complex transactions        | Must be subject to mandatory consultation of the Group's Accounting Policy Director.   | 5.2. |

### 3. General recognition criteria

Below details the general criteria for both recognition and valuation of income which especially applies to hotel occupancy but also other Grupo NH income.

Ordinary income is only recognised if it is probable that the entity will obtain future economic benefits, and these can be estimated reliably. To do this, the standard requires three steps: identify if there are several components in the same agreement, distribute the consideration between the different components and finally recognise ordinary income according to its accrual.

Grupo NH does not routinely carry out transactions in which the price of the contract has to be separately allocated to the different components included in it and, therefore, ordinary income related to the sale of goods or provision of services is recognised based on its accrual. In the event that there is any type of transaction in which sales of goods and/or provision of services are identified whose price or invoice amount is not individualised, a more detailed analysis of it should be performed and, in any case, subjected to mandatory consultation with the Accounting Policy Director.

#### 3.1. Provision of services

The majority of the Group's income comes from the provision of services. Income from ordinary activities associated with the operation should be recognised considering the degree of completion of the final benefit of the reporting period. The result of a transaction can be estimated reliably when it meets each and every one of the following conditions:

- The amount of income from ordinary activities can be measured reliably;
- It is probable that the company receives economic benefits associated with the transaction;
- The degree of completion of the transaction, at the end of the reporting period, can be measured reliably; and
- The costs incurred in the transaction, as well as those which remain to be incurred until completion, can be measured reliably.

Income from ordinary activities will be recognised only when it is probable that the economic benefits associated with the transaction flow to the Group. However, when uncertainty arises as to the degree of recoverability of a balance already included among income from ordinary activities, the non-collectable amount or the amount in respect of which collection is no longer probable is recognised as an expense, in place the originally recognised income amount.

As a general rule, the company will be able to make reliable estimates after having agreed, with the other parties to the operation, the following:

- The rights demanded by each of the parties involved, about the service which the parties must provide or receive;
- The counterpart of the exchange; and
- The forms and terms of payment

A transaction's degree of completion is determined to the extent of which the services have been executed to date as a percentage of the total services to be provided.

Section 4 of this chapter details practical examples of recognition of income.

### 3.2. Sale of goods

Income from ordinary activities arising from the sale of goods must be recognised and recorded in the financial statements at the time each and every one of the following conditions is met:

- The Group has significantly transferred the risks and advantages derived from ownership of the good to the purchaser;
- The Group retains no involvement in the current management of the goods sold, to the degree usually associated with ownership, nor does it retain effective control over them;
- The amount of ordinary income can be measured reliably;
- It is probable that the Group receives economic benefits associated with the transaction; and
- The costs incurred, or to incur, in relation to the transaction can be measured reliably.

The process of assessing when the Group has transferred the significant risks and benefits, implying ownership, to the purchaser requires an examination of the transaction's circumstances. In the case of Grupo NH, the transfer of the risks and advantages of ownership coincides with the transfer of legal ownership or transfer of possession to the purchaser. However, if the company significantly retains risks of ownership, the transaction will not be a sale and therefore income from ordinary activities will not be recognised. In such exceptional circumstances, the authorisation of the Group's Accounting Policy Director will be required.

Income from ordinary activities and expenses related to the same transaction, are recognised simultaneously in accordance with the accounting principle of correlation of expenses with income. Expenses, together with guarantees and other costs to be incurred after the delivery of the goods, may be reliably measured when the other conditions for the recognition of income from ordinary activities have been met.

Section 4 of this chapter details practical examples of recognition of income.

### 3.3. Valuation of income

Income from ordinary activities is valued at the fair value of the consideration received or to be received from it, an amount which normally coincides with the amount paid or to be paid by the customer. Discounts, bonuses or commercial discounts which the Group may grant and whose disbursement is deemed probable at the time of recognition of ordinary income are recorded as a reduction of it.

Fair value is the price which would be received for the provision of a service or selling of an asset in an uncommitted transaction between market participants at the measurement date.

## 4. Typology of Group income

### 4.1. Hotel occupancy

Income from hotel occupancy shall be recognised in accordance with the general criteria for recognition of income set out in section 3 of this chapter. As mentioned in that section, the sale will be recognised at the time of accrual of the provision of the service to the customer.

Normally, the billing procedure followed by the Group is that the private customers make payment at the time of check in, whilst with companies it is usually at check out. However, regardless of billing/collection, income must be recorded according to the accrual. As is usual practice in the sector, the stay is accrued at the end of each day.

For sales with discounts, income will also be recognised at the time of accrual of the service, for the amount resulting from applying the discount. In addition, in cases where sales are made through agencies, the Group will always record sales for their gross amount, irrespective of the commission subsequently paid to the Agency, in accordance with the agreement they have with them.

#### Example

Company A makes a reservation of a single room for an executive who will stay in Madrid for 4 nights. The total price of the room is 800 euros. There is no discount to apply. There is no entry to record at the time of the reservation.

#### Accounting entries

To record the sale, each night the customer uses the room will be accounted for in the following entry:

| Account | Description                          | Debit | Credit |
|---------|--------------------------------------|-------|--------|
| 434     | Guest ledger                         | 200   |        |
| 705     | Income for the rendering of services |       | 200    |
|         | <i>(800 / 4) = 200</i>               |       |        |

To record payment of accommodation at the end of the stay it will be entered as follows:

| Account | Description            | Debit | Credit |
|---------|------------------------|-------|--------|
| 570     | Cash                   | 800   |        |
| 434     | Guest ledger           |       | 800    |
|         | <i>(200 * 4) = 800</i> |       |        |

### 4.2. Other services

Income from restaurant service shall be recognised in accordance with the general criteria for recognition of income set out in section 3 of this chapter.

This heading also includes income from the following: spa, golf, room service, restaurant, car park, etc.

The method used by hotels is that, the customer is billed at the time the service is supplied although the payment is made at the end of the stay. The income should be recorded at the time of the sale/provision of service.

## Example

The customer who is staying in Madrid for 4 nights decides to request room service to order their dinner. The price of the room does not include the requested service. The total price of the service is 50 euros which the customer will pay at the end of their stay.

## Accounting entries

To record the sale, at the time of provision of service it will be accounted for in the following entry:

| Account | Description                  | Debit | Credit |
|---------|------------------------------|-------|--------|
| 430     | Customer accounts receivable | 50    |        |
| 700     | Sales                        |       | 50     |

To record payment of room service at the end of the stay it will be entered as follows:

| Account | Description                  | Debit | Credit |
|---------|------------------------------|-------|--------|
| 570     | Cash                         | 800   |        |
| 430     | Customer accounts receivable |       | 800    |

## 4.3. Rooms

Income from rental of rooms shall be recognised in accordance with the general criteria for recognition of income set out in section 3 of this chapter. As mentioned in that section, the sale will be recognised at the time of accrual of the provision of the service to the customer. Therefore, in the case of accounts receivable, they will not be considered income until the provision of the service.

For sales with discounts, income will also be recognised at the time of accrual of the service, for the amount resulting from applying the discount.

## Example

Company D makes a reservation of a conference room to organise a 5-day conference. The total price of hiring the room for 5 days is 5,000 euros. There is no discount to apply. Company D pays 20% in advance.

## Accounting entries

For the advance payment:

| Account | Description                     | Debit | Credit |
|---------|---------------------------------|-------|--------|
| 570     | Cash                            | 1,000 |        |
| 438     | Advance payments from customers |       | 1,000  |

To record the sale, each rental day will be accounted for in the following entry:

- Day 1:

| Account | Description                          | Debit | Credit |
|---------|--------------------------------------|-------|--------|
| 438     | Advance payments from customers      | 1,000 |        |
| 705     | Income for the rendering of services |       | 1,000  |

- Day 2:

| Account | Description                          | Debit | Credit |
|---------|--------------------------------------|-------|--------|
| 430     | Customer accounts receivable         | 1,000 |        |
| 705     | Income for the rendering of services |       | 1,000  |
|         | $(5,000 / 5) = 1,000$                |       |        |

To record payment of accommodation at the end of the stay it will be entered as follows:

| Account | Description                  | Debit | Credit |
|---------|------------------------------|-------|--------|
| 570     | Cash                         | 4,000 |        |
| 430     | Customer accounts receivable |       | 4,000  |

## 4.4. Levies

Ordinary income from levies charged to hotels operated under management and services provided by Grupo NH Hoteles to third parties, will be recognised following the general criteria for recognising income listed in section 3 of this chapter. As mentioned in that section, the sale will be recognised at the time of accrual of the provision of the service to the customer.

### Example

Company A has formalised a management contract with company B for a period of 10 years. The monthly amount of this levy is 4%. Monthly income amounted to 750,000 in January as stipulated in the contract.

### Accounting entries

To record the income from January, it will be accounted for in the following entry:

| Account | Description                          | Debit  | Credit |
|---------|--------------------------------------|--------|--------|
| 430     | Customer accounts receivable         | 30,000 |        |
| 705     | Income for the rendering of services |        | 30,000 |
|         | $(750,000 \times 4\%) = 30,000$      |        |        |

To record payment of levy by the lessee, it will be entered as follows:

|  |  |  |  |
|--|--|--|--|
|  |  |  |  |
|--|--|--|--|

| Account | Description                  | Debit  | Credit |
|---------|------------------------------|--------|--------|
| 570     | Cash                         | 30,000 |        |
| 430     | Customer accounts receivable |        | 30,000 |

## 5. Other aspects to consider

### 5.1. NH World

Grupo NH has three loyalty programmes: NH Basic, NH Shareholders and NH employees.

The Group uses customer loyalty programmes to offer incentives to use its services. If a customer purchases goods and services, the Group gives them "points" (which the Group calls "credits"). NH offers points as a percentage of the amount billed.

In general terms, as defined in IFRIC 13, a company which gives awards as a reward for loyalty has to allocate some of the results as a liability of the initial sale to the awards (its obligation to give the awards). Therefore, the award is accounted for as a separate component of the sale transaction at the time of sale. Therefore, the sale must be reduced by recognising a liability for the amount equivalent to 100% of the points awarded.

The amount of the results assigned to the awards is measured by reference to their fair value, that is, the amount the award would have had it been sold separately.

The Group should recognise the consideration given to the credits-awards as income from ordinary activities when they are exchanged and fulfils its obligation to provide the awards. The amount of income from ordinary activities recognised should be based on the number of credits redeemed in exchange for awards or discounts, reversing the redemption percentage for the period.

That is to say, at the moment the customer obtains the credits, the Group will record a liability at its fair value and at the time these credits are redeemed they will be carried to income along with those credits which have expired (the Group has defined an expiry period as 3 years since being obtained without having been used).

The Group's policy is to provide for 100% of the credits generated in the period, and when imputing redemptions to results, the calculation will be based on history. That is, based on the historical estimate of the number of points which, of those generated that month, will be redeemed, as well as those which have expired and therefore will never be redeemed.

In short, the income recognised will be:

$$\text{Income} = \text{estimated \% redeemed} + \text{estimated \% expired}$$

Currently, the value of the credit is 1 euro, i.e.: 1 euro=1 credit.

Any change in the value of points must be communicated to and expressly authorised by the Accounting Policy Director.

### 5.2. Complex transactions

The accounting treatment of transactions other than those constituting the normal operations carried out by Grupo NH Hoteles shall be subject to mandatory consultation with the Group's Accounting Policy Director.

In general, income will be recognised when the conditions referred to in section 3 of this chapter are deemed to have been met. In those cases where the price of the contract or the amount to be paid for the different goods or services provided for in the agreements signed with customers is not individualised, it will be necessary to allocate the total price among the different components contemplated in the agreement between the parties, prior to the application of the criteria established in section 3.1 to the different components identified in the contract. To this end, the following steps should be taken into account:

### **Step 1: Identify the components**

The first step in recognising income is to determine whether an agreement encompasses separately identifiable components, which have to be recognised separately.

The standard itself does not include a specific criterion for separating the different components of a transaction although these criteria can be drawn from IAS 11 Construction Contracts in paragraphs 7 and 8 according to which the components of a contract are accounted for as independent contracts when each operates individually, and if different economic proposals have been made for each component each component has been subject to independent negotiation and could have been rejected or accepted; and the costs and income of each component can be identified.

Likewise, IFRIC 18 provides a series of guidelines which are applicable for the purposes of identifying the different components of a contract. According to the aforementioned interpretation, a contract is understood to include several components when:

- The components have a value in themselves for the customer; and
- The fair value of each component can be valued reliably.

### **Step 2.- Distribution of compensation**

When a contract includes several components, the consideration received between them must be allocated to the extent that the accrual of each of them occurs at different times. The distribution methods of the valid consideration are:

- According to their relative fair values; and
- Fair value of undelivered elements.

### **Step 3.- Recognition of ordinary income**

Once the above steps have been taken, the criteria developed in this chapter will apply to the different components identified in each contract which can be separately recognised.

## **6. Related regulations**

1. Subsidies. See module ["Subsidies"](#)



# Accounting policy manual

## Lease rentals

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Approved by:

SVP Consolidation and  
Internal Control

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## Lease rentals

### 1. Scope

This policy is applicable to Group Business Units having leased assets, be they lessee or lessor. Consequently, companies holding signed lease contracts with either third parties or other Group companies fall within the scope of this rule.

This chapter includes all leases and sale & leaseback operations.

The accounting criteria under this policy are derived from the application of the following international regulation:

| IAS / IFRS | Description   |
|------------|---|
| IAS 17     | Lease rentals   |
| IFRSIC 4   | Determining whether the agreement is a lease                          |
| SIC 15     | Operating leases  |
| SIC 27     | Evaluating the substance of transactions in the legal form of a lease |

International Accounting Standard 17 is currently under review so, as and when changes to the standard are made, the Accounting Policy Director must update the manual which should then subsequently be approved by the Standards Committee.

### 2. Executive Summary

| Area                        | Concepts  | Ref.        |
|-----------------------------|---|-------------|
| <b>Lease contracts</b>      |   |             |
| Contract signature date     | An analysis is made on the classification of the contract as operating or financial.  | 3.2.        |
| Lease start date            | The date on which the hotel/asset is made available.  | 3.3.        |
| Non-cancellable period      | The one which cannot be cancelled.  | 3.4.1.      |
| Lease term                  | Initial term plus any extensions where there is the right to continue with the lease without renegotiating the rental.  | 3.4.2.      |
| <b>Financial lease</b>      |   |             |
| Definition                  | Those which substantially transfer the risks and rewards deriving from ownership to the lessee and, under the terms of which, the lessee holds an acquisition option on the asset at the end of the agreement under conditions which could be clearly deemed as more advantageous than in the contract. | 3.1 and 4.1 |
| From the lessee's viewpoint | It will register:<br>* An asset according to its nature, such as a tangible fixed asset or an intangible asset, and<br>* A financial liability for the same amount based on the term in which it will be settled.   | 4.2.        |
| From the lessor's viewpoint | The owner of the asset under the contract will treat it as a lease as if a sale with deferred payment was treated by derecognising the asset and accounting for an account receivable from the lessee. (See chapter on "financial investments").  | 4.3.        |
| <b>Operating leases</b>     |   |             |
| Operating leases            | The income and expenses corresponding to the lessor and the lessee  | 5.          |

|                                    |   |      |
|------------------------------------|---|------|
|                                    | and derived from the operating lease agreements will be considered, respectively, as income and expense for the year in which they are accrued, being charged to the profit and loss account.   |      |
| <b>Sales with subsequent lease</b> |   |      |
| Sale and financial lease           | Any excess on sales price above the book amount of the disposed asset will not immediately be recognised as a profit in the financial statements of the seller lessee. This excess will be deferred and amortised over the term of the lease. | 6.1. |
| Sale and operating lease           | When determining the result of the operation in the profit and loss account, the fair value of the operation's asset must be determined and compared with its sale price.   | 6.2. |

### 3. Lease contracts

#### 3.1. Types of lease

A lease can be classified as operating or financial and this determines its accounting treatment.

Lease contracts should be analysed at the contract signature date to determine its classification. This classification is not revised unless the agreement is changed.

To qualify a lease as financial or operating, the indicators in section 4 should be assessed. The Group generally classifies all leases as operating leases. Only those leases which substantially transfer to the lessee the risks and rewards deriving from ownership and under the terms of which the lessee holds an acquisition option on the asset at the end of the agreement under conditions that could be clearly deemed as more advantageous than market conditions are classified as finance leases. If the analysis of any contract arrives at a different conclusion, it must be reviewed by the Group's Accounting Policy Director.

#### 3.2. Lease contract signature date

The lease contract signature date is the date on which its main conditions are agreed.

It is the date on which an analysis is made on the classification of the contract as an operating or financial lease.

#### 3.3. Lease start date

The lease contract start date is the date on which the premises/asset becomes available. It is the date on which a lease expense is recorded.

If dealing with a hotel, the start date will be the same as the entry into force or availability of the hotel.

#### 3.4. Lease term and non-cancellable period

##### 3.4.1. Lease non-cancellable period

The non-cancellable period of the lease is that in which it cannot be cancelled by the lessee. This non-cancellable period may be established in the contract or even cover the entire first full period of the lease, if in case of wanting to cancel it, for example, the lessor's approval is required or there is a penalty which makes it "reasonably certain" that, at the beginning of the contract, the lessee will continue with the lease, or will be obliged to sign a new contract with the lessor for an equivalent asset.

For example, if the lease term is nine years but the lessee can cancel the lease without penalty at the end of the third year then the non-cancellable period of the contract will be three years unless that at the start of the lease there is reasonable certainty that the lessee will not cancel the lease after three years.

To determine when "reasonable certainty" exists, the current circumstances at the start of the contract will be considered, rather than the company's intentions. The standard includes no specific guideline to determine how "reasonable certainty" is assessed.

The Grupo NH criterion to determine the lease's non-cancellable period is to consider the period from the availability of the asset until the time at which the contract may be cancelled without penalty, regardless of whether said cancellation is reasonably certain.

### 3.4.2. Lease term

The lease term determines the lineal attribution period of the lease expense.

The lease term starts when the lessee has the right to use the leased asset (i.e. on the start date defined in section 3.3) and includes:

- The lease's non-cancellable period as defined in point 3.4.1
- and any additional period in which the lessee has the right to continue the lease without renegotiating the rent and which, at the start of the contract, there was reasonable certainty that this option would be exercised.

The relevant factors for the assessment may include, for example, the amount of rent payable during the second period of the lease when compared with the market for a similar asset over said period, the importance of the asset's continuous use for the lessee's business model and the ability of the lessee to recover the costs incurred in making improvements to the leased asset. Reasonable certainty occurs when economic circumstances entice renewal of the lease.

Grupo NH's criterion for determining the lease term is to consider the initial term of the lease plus any extension in which it has the right to continue with the lease without renegotiating the rent, if at the start of the contract Grupo NH has reasonable certainty that it will exercise the extension option.

### 3.4.3. Determination of minimum lease payments

The minimum lease payments are those which the lessee makes during the lease term, or may be required to do, excluding both the contingent instalments and the costs of services and taxes to be paid by the lessor and have to be reimbursed. It also includes any amount guaranteed by them or a linked third party.

The following concepts/amounts will be included as part of the minimum payments to be made by the lessee.

- The amounts which may be required by the lessee during the lease term (the initial period without extensions as defined above).
- The amounts guaranteed by the lessee or a related party.
- The amount corresponding to the purchase option if, at the start of the lease, there is a reasonable certainty that the option will be exercised. That would be the case if, for example, the option's fixed price is significantly lower than the asset's fair value on the exercise date. The Group usually doesn't sign operating lease contracts with a purchase option.

The minimum lease payments do not include the leases contingent fees (CPI or variable fees as a percentage of sales). In this sense, a lease with 100% variable rents would not have minimum lease payments.

## 4. Financial lease

### 4.1. Definition

When the economic conditions of a lease agreement infer that all the risks and benefits inherent to the ownership of the asset under the contract are substantially transferred, the agreement should be qualified as a financial lease.

In a lease agreement of an asset with a purchase option, it will be presumed that all risks and benefits inherent to ownership are substantially transferred when there is no reasonable doubt that said option will be exercised. Except with evidence to the contrary, said transfer will also be presumed, even where there is not purchase option in the following cases, among others:

| Financial lease indicators   |
|--|
| Ownership of the asset transfers to the lessee at the end of the lease period.   |
| There is a purchase option for a residual amount and at the start of the lease it was known with reasonable certainty that said option would be exercised. |
| The lease period represents most of the economic life of the asset.  |
| At the start of the lease, the current value of the minimum lease payments is equal to the asset's fair value.   |
| The asset is of such specific nature that only the lessee could use it without substantial modifications being made.                                       |
| The lessee can terminate the lease contract with the losses due to the cancellation being the responsibility of the lessee.                                |
| The gains or losses due to fluctuations in fair residual value lie with the lessee.  |
| The lessee has the possibility of extending the lease for an additional period through the payment of rents substantially below that of the market.        |

### 4.2. From the lessee's viewpoint

#### 4.2.1. Initial recognition

If the substance of a lease is considered to be financial, the lessee will record it as follows at the beginning of the lease:

- The asset according to its natural, such as a tangible asset or an intangible asset, and
- A financial liability for the same amount based on the term in which it will be settled; i.e. recording the part of the lease instalments which will be settled in the following 12 months as a current financial liability and the remainder as a non-current financial liability.

This way, the lease of an asset will be recorded in accordance with the contract's economic substance, regardless of its legal form.

The value of the asset under the contract will be the lower between:

- The fair value of the asset at the start of the contract, and
- The current value of the minimum payments established for the lease term, including the payment of the purchase option where no doubts exist as to its execution.

In this sense, it should take into account:

- That calculation of the lease payments should not include service costs or taxes which the lessor can recover such as insurance or maintenance.
- That if the lessee incurs direct expenses before the asset is in operating conditions, they should be recorded as the greater value of the asset.
- The interest rate quoted in the contract will be used to calculate the current value of the lease payments; if it cannot be determined in this manner, market interest rates on similar operations will be used instead.

## 4.2.2. Subsequent valuation

The debt will be valued at its current value and the full amount of the contract's interest will be distributed throughout the term or duration of the lease and will be attributed to or recorded on the profit and loss account in which it accrues using the effective interest rate (see chapter ["financial instruments"](#)).

The asset will be amortised as follows:

- Using the lower of the useful life or lease term if there is no reasonable certainty that ownership of the leased asset will be obtained.
- Using criteria for equivalent assets if there is reasonable certainty that ownership will be obtained.

## 4.2.3. Examples

### Example 1

As the result of signing a fixed asset lease contract classed as financial, Grupo NH will record the leased asset as well as the financial liability associated with it for the amount calculated as described above through the following entry:

| Debit        |                                    |    | Credit                                   |
|--------------|------------------------------------|----|--|
| (20) or (21) | Intangible or tangible fixed asset | TO | (174) Non-current finance lease payables |
|              |                                    |    | (524) Current finance lease payables     |

\* Based on the nature of the leased asset.

From this moment, the asset will be assessed in accordance with its nature (see chapters ["Property, plant and equipment"](#) and ["Intangible assets"](#), and debt incurred according to the effective interest rate (see chapter ["Financial instruments"](#)).

### Example 2

On 31/03/X, Grupo NH acquires ten computers whose useful life is estimated at four years. This equipment has been financed with a financial lease contract from which the following data are extracted:

Current value of the payments made over the life of the financial lease contract: 10,818 euros

Interest on the operation: 6% per annum

Number of payments: 6, paid quarterly

The creditor entity provide an amortisation table, which we provide below:

| Number of payments | Principle outstanding | Payment of Principal | Interest |
|--------------------|-----------------------|----------------------|----------|
| 1                  | 10,818                | 31.03.20x1           | 649.8    |
| 2                  | 9,015                 | 30.06.20x1           | 540.9    |
| 3                  | 7,212                 | 30.09.20x1           | 432.72   |
| 4                  | 5,409                 | 31.12.20x1           | 324.54   |
| 5                  | 3,606                 | 31.03.20x2           | 216.36   |
| 6                  | 1,803                 | 30.06.20x2           | 108.18   |

Firstly, you need to record the entry for the acquisition of the equipment and the debt incurred:

| Debit  |  |    |  | Credit |
|--------|--|----|--|--------|
| 10,818 | (217) Information technology equipment | to | (524) Current finance lease payables (*)     | 7,212  |
|        |  |    | (174) Non-current finance lease payables (*) | 3,606  |

\*The debt should be accounted for as long or short-term debt according to its maturity.

If the financial lease is divided into 18 months, it will be necessary to classify which part is recorded as short term and which as long term:

Short term will be the first 12 months:  $10,818 / 18 \times 12 = 7,212$  euros

Long term will be the remaining 6 months:  $10,818 - 7,212 = 3,606$  euros

The entry for accrued interest to record monthly will be as follows:

| Debit |                                      |    |                                    | Credit |
|-------|--------------------------------------|----|------------------------------------|--------|
|       | (6624) Debt interest other companies | to | (528) Current interest on payables |        |

Subsequently, monthly, coinciding with cash outflow:

The amount of principal to pay would be: 1,803 euros

The amount of interest payable, for the first month according to the table, is 649.80 euros

| Debit |                                      |    |             | Credit |
|-------|--------------------------------------|----|-------------|--------|
| 1,803 | (217) Current finance lease payables | to | (572) Banks | 2,453  |
| 650   | (528) Current interest on payables   |    |             |        |

On 31/12/X1 the long-term amounts will have to be transferred to short term given that their maturity will require it.

Therefore, the required entry would be:



| Debit |  |    |                                      | Credit |
|-------|--|----|--------------------------------------|--------|
| 3,606 | (174) Non-current finance lease payables | to | (520) Current finance lease payables | 3,606  |

*In year x+1*

- The accrual of interest entry would return to repeating monthly.
- Quarterly, until the sixth payment, the entry for payment of principal and interest would also be repeated.

At the same time, the asset should be amortised according to its nature and useful life set at a Group level and as laid out in the Chapter ["Property, plant and equipment"](#)

## 4.3. From the lessor's viewpoint

An account receivable is recorded the lessee for the amount of the net investment in the lease.

Net investment in the lease= (Minimum lease payments receivable + residual value) discounted at the interest rate implied in the lease

The accounts receivable throughout the lease will have a double impact:

- Repayment of the principle
- Financial remuneration for the investment and the services supplied.

However, it is not Group policy to enter into such contracts as lessor.

## 5. Operating leases

### 5.1. Definition

This is an agreement whereby the lessor agrees with the lessee the right to use an asset for a specified period of time in exchange for a single amount or a series of payments or instalments, without it considered a financial lease.

### 5.2. From the lessee's viewpoint

Operating lease instalments are charged as expenses on a straight-line basis.

As a result of the cost of rents contracted with third parties for the payment of rent or rental instalment, which normally occurs each month, the Group should record the following entry to the rent accrual:

| Debit                      |    |  |  | Credit |
|----------------------------|----|--|--|--------|
| (621) Leases and royalties | to | (410) Payables for the rendering of services |  |        |
|                            |    | (57X) Cash                                   |  |        |

The instalment derived from operating leases are recognised as an expense on a straight-line basis over the term of the lease. The lessee will record the expense in the "Leases and royalties" account.

### 5.3. From the lessor's viewpoint

Leased assets are presented in the lessor's financial position statement and income is recognised on a straight-line basis over the term of the lease, any initial expense incurred in the deal is added to the carrying book value of the leased asset. Assets are amortised following the criteria set out in chapters "[Intangible assets](#)" and "[Property, plant and equipment](#)".

For the accrual of interest, the Group should record the following entry:

| Debit             |    |                                    | Credit |
|-------------------|----|------------------------------------|--------|
| (440) Receivables | to | (752) Income from lease agreements |        |
| (57X) Cash        |    |                                    |        |

### 5.4. Example

Company A rents a business premises to Company B for 4,800 euros per year, paid monthly

The amount to pay per month for leasing the premises will be:  $4,800/12=400$  euros

Lessee entry:

| Debit |                            |    | Credit          |
|-------|----------------------------|----|-----------------|
| 400   | (621) Leases and royalties | to | (572) Banks 400 |

Lessor entry:

| Debit |                   |    | Credit                                 |
|-------|-------------------|----|--|
| 400   | (440) Receivables | to | (752) Income from lease agreements 400 |

### 5.5. Special case: linearisation of revenue

The regulations establish that the expense derived from an operating lease should be allocated to the profit and loss account on a straight line basis, regardless of the payment premium. In practice, the instalments agreed upon from the start of the contract are fixed with updates based on reference indices (e.g. CPI) which are linearised. However, the impact of such linearisation should be assessed in the following cases:

- Contracts with grace periods
- Contracts with increasing or decreasing rents (without taking the updated CPI into consideration).
- Obtaining or granting of bonuses by contract signature or renegotiation.

In these cases, the expense flow will be independent from the payment for the lessee or, in the case of the lessor, the income flow will be different from the collection flow.

#### Example 1: Contract with grace period

Company XYZ rents on of its properties for a total of 12,000 euros to Company ABC for 1 year with two months' grace.

|                       | 1     | 2     | 3     | 4     | 5     | 6     | 7     | 8     | 9     | 10    | 11    | 12    |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Rent on contract      | 0     | 0     | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 |
| Rent on linearisation | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Difference            | 1,000 | 1,000 | -200  | -200  | -200  | -200  | -200  | -200  | -200  | -200  | -200  | -200  |

**Rent on contract:** the monthly distribution following the conditions set out in the lease contract, of the income/expense for rentals.

**Rent on linearisation:** according to the criteria for the linearisation of rents and based on an annual rental amount of 12,000 euros the uniform and monthly amount to record would be:  $12,000/12=1,000$  euros per month.

**Difference:** The account to be accrued as a consequence of those particular conditions established for a certain period of time in the contract (since in this case the payments/collections flow is different from that of expense/income).

### From the lessor's viewpoint:

Based on the above, they will have to linearise the income they will receive for the rent over the life of the contract. This supposes that it is not the first month, before the non-payment of rent, that is not going to reflect an income, but that the following must be done:

The entry to record the first will be:

| Debit |                           |    |  | Credit |       |
|-------|---------------------------|----|--|--------|-------|
| 1,000 | (4XX) Accrual adjustments | to | (705) Income for the rendering of services |        | 1,000 |

### From the lessee's viewpoint the account would be the reverse, as follows:

For the first two months of the lease, they will have to make the following entry:

| Debit |                            |    |                           | Credit |       |
|-------|----------------------------|----|---------------------------|--------|-------|
| 1,000 | (621) Leases and royalties | to | (4XX) Accrual adjustments |        | 1,000 |

### Example 2: Contract with increasing rents

Company XYZ rents one of its properties for a total of 11,000 euros to Company WSX over 1 year. It has been stipulated that the first two months have a 50% discount on the monthly rent.

Firstly, we summarise the main economic conditions of the contract in the following table:

|                       | 1   | 2   | 3     | 4     | 5     | 6     | 7     | 8     | 9     | 10    | 11    | 12    |
|-----------------------|-----|-----|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Rent on contract      | 500 | 500 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Rent on linearisation | 917 | 917 | 917   | 917   | 917   | 917   | 917   | 917   | 917   | 917   | 917   | 917   |
| Difference            | 417 | 417 | -83   | -83   | -83   | -83   | -83   | -83   | -83   | -83   | -83   | -83   |

**Rent on contract:** the monthly distribution following the conditions set out in the lease contract, of the income/payment for rentals.

**Rent on linearisation:** according to the criteria for the linearisation of rents and based on an annual rental amount of 11,000 euros the uniform and monthly amount to record would be:  $11,000/12=917$  euros per month.

**Difference:** the amount which will be recorded as accruals (as in this case the flow of payments is different from income). It is the account to be accrued as a consequence of those particular conditions established for a certain period of time in the contract.

**From the lessor's viewpoint:** the entries which will have to be made each month would be:

| Debit |                           |    |  | Credit |
|-------|---------------------------|----|--|--------|
| 917   | (4XX) Accrual adjustments | to | (705) Income for the rendering of services | 917    |

**From the lessee's viewpoint** the account would be the reverse, as follows:

| Debit |                            |    |                           | Credit |
|-------|----------------------------|----|---------------------------|--------|
| 917   | (621) Leases and royalties | to | (4XX) Accrual adjustments | 917    |

### Example 3: obtaining of bonus by contract signature:

Company SDF rents a business premises to Company XXZ. As a result of having done so, on a specific date said hotel grant the lessee a bonus of 10,000 euros. The lease contract for a year is for a total of 24,000 euros.

Firstly, we summarise the main economic conditions of the contract in the following table:

|                       | 0    | 1   | 2   | 3   | 4   | 5   | 6   | 7   | 8   | 9   | 10  | 11  | 12  |
|-----------------------|------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Rent on contract      | 1000 | 20  | 20  | 20  | 20  | 20  | 20  | 20  | 20  | 20  | 20  | 20  | 20  |
| Rent on linearisation | 0    | 16  | 16  | 16  | 16  | 16  | 16  | 16  | 16  | 16  | 16  | 16  | 16  |
| Difference            | 1000 | 833 | 833 | 833 | 833 | 833 | 833 | 833 | 833 | 833 | 833 | 833 | 833 |

**Rent on contract:** the monthly distribution following the conditions set out in the lease contract, of the income for rentals including the amount of the bonus from the outset.

**Rent on linearisation:** once the bonus was discounted ( $24,000 - 10,000 = 14,000$ ) and according to the criteria for the linearisation of rents and based on a new annual rental amount of 14,000 euros the uniform, monthly amount to record would be:  $14,000/12=1,167$  euros per month.

**Difference:** the amount to accrue during the life of the contract as a result of the bonus received by the lessee on signing the contract.

**NOTE:** while a bonus would consist of a discount of the amount to be paid by the lessee, a premium for a rental contract would be the amounts paid to third parties other than the lessee as a condition for obtaining certain hotel lease agreements which entails an intangible asset (see chapter ["Intangible Assets"](#)).

**From the lessor's viewpoint:**

At the time of granting the money:

| Debit  |                           |    |            | Credit |
|--------|---------------------------|----|------------|--------|
| 10,000 | (5xx) Short-term accruals | to | (572) Cash | 10,000 |

Subsequently, based on the accrual of the lease contract each month that amount accrued will have to be charged to income, as follows:

| Debit |                   |    |  | Credit |
|-------|-------------------|----|--|--------|
| 2,000 | (440) Receivables | to | (705) Income for the rendering of services | 1,167  |
|       |                   |    | (5xx) Short-term accruals                  | 833    |

**From the lessee's viewpoint**, as previously explained the entries will be the reverse:

At the time the money is received, on signing the contract

| Debit  |            |    |                           | Credit |
|--------|------------|----|---------------------------|--------|
| 10,000 | (572) Cash | to | (4XX) Short-term accruals | 10,000 |

Subsequently, the amounts accrued will be allocated to results:

| Debit |                            |  |  | Credit |
|-------|----------------------------|--|--|--------|
| 1,167 | (621) Leases and royalties |  | (410) Payables for the rendering of services | 2,000  |
| 833   | (4xx) Short-term accruals  |  |  |        |

## 6. Sales with subsequent lease

### 6.1. Sale and financial lease

The Group has to determine if it is a financial lease as explained in section 4.1. If determined to be a financial lease, if there is a sale with a subsequent financial lease it is considered that there is no sale and therefore no derecognition of the asset. Any excess on sales price above the book amount of the disposed asset will not immediately be recognised as a profit in the financial statements of the seller lessee. This excess will be deferred and amortised over the term of the lease.

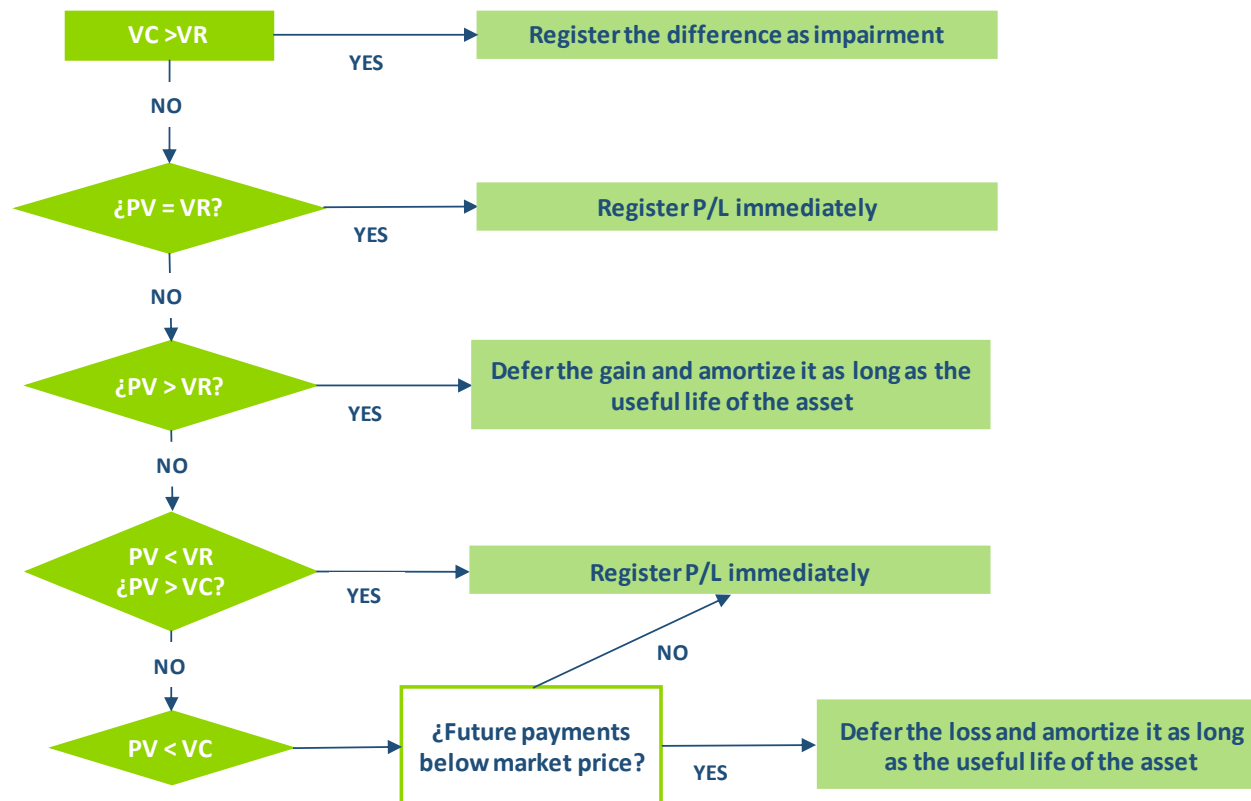
### 6.2. Sale and operating lease

If the sale with subsequent lease results in an operating lease, when determining the result of the operation in the profit and loss account, the fair value of the operation's asset must be determined and compared with its sale price.

If a sale with subsequent lease were to result in an operating lease and it were clear that the operation was at fair value, any result will be recognised immediately as such. Were the selling price to be less than the fair value, any result is recognised immediately, unless the loss were to be offset by future instalments below market prices, in which case it will be deferred and amortised in proportion to the instalments paid during the period in which the asset is expected to be used. Were the selling price to be greater than the fair value, said excess will be deferred and amortised during the period in which the asset is expected to be used.

In operating lease contracts, if the fair value of the asset at the time of sale with subsequent lease were less than its book amount, the loss resulting from the difference between both figures will be recognised immediately.

In short, the procedure for a sale with subsequent operating lease would be the following:



## 7. Related modules

1. Property, plant and equipment See module [“Property, plant and equipment”](#)
2. Intangible assets. See module [“Intangible assets”](#)
3. Onerous contracts. See module [“Provisions, contingent assets and liabilities”](#)

# Accounting policy manual

## Income tax

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Approved by:

SVP Consolidation and Internal  
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## Income tax

### 1. Scope

This accounting policy will be applicable to the registration of income tax, understood as those taxes whose calculation is based on the taxable profits of the company as well as withholdings on dividends distributed by the companies included in the Grupo NH consolidated perimeter. The year's income tax expense is calculated through the sum of the current tax resulting from applying the tax rate to the taxable income for the year and then applying the relevant tax adjustments according to the law plus any changes in deferred tax assets and liabilities.

The accounting criteria under this policy are derived from the following international regulation:

| IAS / IFRS | Description                 |
|------------|-----------------------------|
| IAS 12     | Income taxes                |
| IAS 34     | Interim Financial Reporting |

### 2. Executive Summary

| Area                                    | Concepts  | Ref. |
|---|---|------|
| <b>Current tax</b>                      |   |      |
| Concept                                 | Current tax represents the amount to be paid (recoverable) by the tax on the profits related to the taxable profit (loss) of the year.  | 3.   |
| Recognition                             | A current tax liability (or asset) is recognised for the amount payable corresponding to corporation tax for the year.  | 3.1. |
| Valuation                               | The valuation of the current tax is based on the current tax rate. Current tax assets and liabilities are not financial assets or liabilities, so the amounts calculated are not subject to being updated.  | 3.2. |
| Presentation                            | They will be presented separately in the statement of financial position and, as a counterpart, will generally be recorded in profit or loss, except in business combinations or if they were produced by items recorded directly in equity.  | 3.3. |
| Offset                                  | Current tax assets and liabilities are only offset if the company has the legal right to do so, and if it has the intention to cancel it in net terms, or realise an asset and cancel the liability simultaneously.   | 3.4. |
| <b>Deferred tax</b>                     |   |      |
| Concept                                 | Deferred taxes will be recognised to reflect the future tax implications of the realisation of assets or cancellation of liabilities.   | 4.   |
| Identification of temporary differences | Temporary differences arise from differences between the book value of assets and liabilities and their value or tax base. They may be deductible or taxable depending on whether they result in lower (greater) taxation in the future when the assets and liabilities are recovered or settled. | 4.1. |
| Determination of tax bases              | The tax basis of assets and liabilities is the amount attributed to the aforementioned assets based on tax legislation.   | 4.2. |
| Recognition of deferred tax liabilities | Deferred tax liabilities are recognised for each and every one of the temporary differences which occur, except in certain exceptions.  | 4.3. |

|  |   |      |
|--|---|------|
| Recognition of deferred tax assets                     | Deferred tax assets are only realised to the extent that it is probable that sufficient tax benefits are available to apply the aforementioned deductible temporary differences.  | 4.4. |
| Valuation  | Deferred tax assets and liabilities will be valued taking into account the way in which the asset is expected to be recovered or the liability cancelled and the applicable rate which is approved or about to be. Deferred tax assets and liabilities are not financial assets or liabilities, so the amounts calculated are not subject to being updated.   | 4.5. |
| Classification and presentation                        | They will generally be presented as non-current assets or liabilities with counterpart in profit or loss, except those arising in business combinations or when generated by items recorded directly in equity.   | 4.6. |
| Items recorded in equity                               | The tax burden will be recorded along with the item which generated it, that is, in the case of income and expenses recognised directly in equity, its tax burden will also be recorded in equity.  | 4.7. |
| <b>Other aspects</b>                                   |   |      |
| Withholding of dividend taxes                          | The company which distributes the dividend merely acts as a tax collector on behalf of the shareholder. These taxes are recognised therefore in the company's equity as part of the distribution to shareholders.   | 5.1. |
| Profit or loss on transactions between group companies | Transactions between group companies are eliminated in the accounting consolidation process, the elimination is not complete if the two companies involved in the transaction have different tax rates.   | 5.2. |
| Foreign currency and hyperinflation                    | This exchange rate difference may generate temporary differences, the recognition criteria of which are those described in the previous sections.<br><br>In the case of companies located in hyperinflationary countries, temporary differences arise as a result of the current purchasing power adjustments applicable to the assets if the tax base is maintained at the historic unit of measurement.   | 5.3. |
| Tax consolidation                                      | In forming a tax group, it is the group itself which acts as the taxable subject in all formal and material obligations, and the parent company that which represents it.<br><br>The taxable base of the group will be based on the aggregation of individual taxable bases on which adjustments resulting from the consolidation will be made.<br><br>The main peculiarities of the regime, which can lead to taxation lower than the aggregate of the companies which compose it are: <ul style="list-style-type: none"> <li>▪ The deferral of taxation on operations between the companies that make up the tax group, which will only be taken into account in the calculation of the group's tax when carried out against third parties.</li> <li>▪ The offset of positive and negative bases obtained by different group companies.</li> <li>▪ Application of deductions at a group level.</li> <li>▪ The non withholding on internal dividends.</li> </ul> | 5.4. |
| <b>Calculation of tax in interim periods</b>           |   |      |
| Calculation of tax in interim periods                  | In interim periods, the tax expense should be calculated on the average effective tax base which is expected to apply to the full period. In the interim periods, the deferred taxes of temporary differences which are not moved to profit/(loss) are not calculated.<br><br>Likewise, the impacts of non-deductible expenses will be considered in the interim profit/(loss) calculation.   | 6.   |

### 3. Current tax

Current tax represents the amount to be paid (recoverable) by the tax on the profits related to the taxable profit (loss) of the year. The tax gain or loss is determined based on the applicable tax regulations in each of the tax jurisdictions where the group entities operate.

#### 3.1. Recognition

A current tax liability (or asset) for tax payable (or paid but recoverable) towards tax on profits relating to past years is recognised. If the amount already paid, which corresponds to the current year and to previous ones, exceeds the amount to be paid for those years, the excess must be recognised as an asset.

When a tax loss is used to recover the current tax paid in previous years, the company will recognise that right as an asset in the same year in which the tax loss occurred, since it is probable that the company will obtain the economic gain derived from such a right and, in addition, that gain can be reliably valued.

#### Example

In year X, Grupo NH obtained an accounting and tax gain of 1,000 euros; the tax rate of the country in which the company operates is 30%. Thus, Grupo NH should pay the Treasury 300 euros in Corporation Tax; given that Grupo NH carries out tax consolidation with Group Companies, not all of the tax payment is attributable to the parent company. See section 5.4 of this document.

The entry to record at a Group level is as follows:

| Debit     |                       |    |       |                          |  | Credit |
|-----------|-----------------------|----|-------|--------------------------|--|--------|
| 100 (630) | Income tax            |    |       |                          |  |        |
| 200 (432) | Group Company Debtors | to | (47X) | Treasury CT Withholdings |  | 300    |

*We assume that, of the total amount (€300), €100 corresponds to the Corporation Tax of Grupo NH's parent company while €200 is attributed to the total of Group Companies, with a collection right for that amount being accounted for in the balance sheet of the parent; as well as a payment obligation in the subsidiaries.*

*Therefore, in the balance sheet of each of the group companies a payment obligation to the NH parent company will be created for the amount of Corporation Tax corresponding to each of the Group Companies, accounting for it as indicated below:*

| Debit     |            |    |       |                                |  | Credit |
|-----------|------------|----|-------|--------------------------------|--|--------|
| 200 (630) | Income tax | to | (510) | S/T Debts with Group Companies |  | 200    |

#### 3.2. Valuation

The valuation of current tax is made according to the tax rate in force or about to be approved.

Current tax assets and liabilities are not financial assets or liabilities, so the amounts calculated are not subject to being discounted.

#### 3.3. Presentation

Current tax assets and liabilities are presented on a separate line of the statement of financial position as current assets and liabilities.

The presentation of tax expenses are generally recorded in profit/(loss), except when arising from:

- A business combination
- Items recognised in other comprehensive income or directly in equity

### 3.4. Offset

Current tax assets and liabilities are only offset if:

- The company has a legal right to offset current tax assets and liabilities, normally in the case of taxes related to the same tax jurisdiction and this allows the entity to make a single net payment; and
- The entity intends to cancel it in net terms, or realise the asset and cancel the liability simultaneously.

#### Example

At the end of the year, the account payable to the Treasury as income tax for the year will be presented net of payments on account made during the year.

## 4. Deferred tax

Deferred taxes will be recognised to reflect the future tax implications of the realisation of assets or cancellation of liabilities.

Deferred taxes will therefore be recognised for temporary differences, for tax losses and tax credits for prior years pending offset.

### 4.1. Identification of temporary differences

Temporary differences arise from differences between the book value of assets and liabilities and their value or tax base. The temporary differences may be deductible or taxable depending on whether they result in greater or lower taxation in the future when the assets and liabilities are recovered or settled.

The temporary differences are calculated following the balance sheet method, i.e., comparing the balances of the statement of financial position with the tax balance sheet.

#### Example

Company A has a fixed asset (equipment) registered for a cost of 1,000 euros and a useful life of 10 years. Company A has used the accelerated depreciation tax regime in such a way that 100% depreciation has been made in the first year. In the statement of financial position, the net book value of the asset at the end of the first year amounts to 900 euros while its tax base is 0, there being a temporary difference of 900 euros; as the years go by, the temporary difference will be reduced to the extent that the accounting depreciation is recorded. The temporary difference is taxable, and represents the tax obligation for the tax gain greater than that to account for had the asset been realised.

#### Accounting entries

| Debit |        |                                |    | Credit |                                       |
|-------|--------|--------------------------------|----|--------|---------------------------------------|
| 270   | (6301) | Deferred taxes (900*30%) = 270 | to | (4755) | Liabilities for temporary differences |
|       |        |                                |    | 270    |                                       |

In another example, Company B has recorded a provision for insolvencies in the amount of 100 euros which is not deductible for tax purposes until the customer is declared insolvent. The value of the provision in the statement of financial position amounts to (100) euros compared to the tax value of 0. The temporary difference produced is deductible.

## Accounting entries

| Debit |        |                                  |    |  | Credit |
|-------|--------|----------------------------------|----|--|--------|
| 30    | (4705) | Assets for temporary differences | to | (6301) Deferred taxes $(100 \times 30\%) = 30$ | 30     |

## 4.2. Determination of tax bases

The tax basis of assets and liabilities is the amount attributed to the aforementioned assets based on tax legislation.

The tax base of an asset is the amount which will be deductible for tax purposes from the taxable economic benefits the company has when it recovers the value of that asset.

The tax base of a liability is equal to its book value less any amount which may be tax deductible in future years.

In some cases differences arise between the accounting record and the tax treatment which are not temporary differences given that the item affected will not be deductible nor taxable. These differences are considered permanent differences (although this concept is not contemplated in the standard referenced).

## Example

One of the companies held by company A has approved the distribution of a dividend for 100 euros, A has recognised a collection right. Dividends in A's tax jurisdiction are tax exempt. Therefore, no deferred tax liability will be recognised since the tax base of the collection right is 100 and the profits will not be taxed, therefore there will be no temporary difference.

## 4.3. Recognition of deferred tax liabilities

### 4.3.1. General rule

Deferred tax liabilities are recognised for each and every one of the temporary differences which occur, except where the tax comes from:

- The initial recognition of goodwill:

In those cases where goodwill is not tax deductible, a temporary difference is generated which will not give rise to the recognition of deferred tax since goodwill is valued on a residual basis and the recognition of deferred tax would result in an increase of said goodwill. Subsequent changes in the initial difference will not result in recording deferred tax.

Where the goodwill is deductible, a temporary difference and therefore deferred tax is not initially generated, although when a temporary difference is subsequently generated by the tax depreciation, it is not the difference in the initial recognition of goodwill, and therefore not within the scope of exceptions.

- The initial recognition of an asset or liability in a transaction which is not a business combination; and on the date of the transaction affects neither the accounting result nor the taxable profit.

By way of example, company A plans to use a productive asset, whose cost was 1,000 euros, over its five-year life, and then sell it at a price of zero. The tax rate is 40%. The depreciation of the asset is fiscally

non-deductible. When sold, the capital gain obtained is not taxable and, if losses occur, they would not be deductible.

As the company recovers the asset's book value, the company will earn taxable income of 1,000 and will pay taxes of 400. The company is not required to recognise the corresponding deferred tax liability of 400 because it is derived from the initial recording of the productive asset.

- Taxable temporary differences associated with investments in subsidiaries, associates and joint ventures are not recognised if:
  - Their reversal can be controlled
  - It is probable that said reversal will not occur in the foreseeable future (12 months)

Recognition of deferred tax liabilities is made in full and not in part as in the case of assets.

## 4.4. Recognition of deferred tax assets

### 4.4.1. General rule

Deferred tax assets are only realised to the extent that it is probable that sufficient tax benefits are available to apply the aforementioned deductible temporary differences.

- Deferred tax assets will not be recognised for temporary differences arising on the initial recognition of an asset or liability in a transaction which is not a business combination; and on the date of the transaction affects neither the accounting result nor the taxable profit.
- Deductible temporary differences associated with investments in subsidiaries, associates and joint ventures are not recognised if:
  - Their reversal can be controlled.
  - It is probable that said reversal will not occur in the foreseeable future (12 months).

In assessing if there will be sufficient tax benefits, considered will be:

- The reversal of taxable temporary differences in the reversal period of the deductible differences.
- Period in which the tax loss derived from the deductible temporary difference can be applied.
- Probability of obtaining future tax gains in the reversal period of the deductible temporary differences.

#### a) Deductible temporary differences

In order to assess whether the requirements for recognising a deferred tax asset arising from deductible temporary differences are met, it is necessary to know the reversal period of those differences.

##### Example

A company has recorded a liability for staff remuneration which has generated a temporary deductible difference of 1,200 euros. The tax rate is 30%. For tax purposes, the deduction of expenses occurs at the time of disbursement, and this will occur within two years. In turn, the company has a deferred tax liability as a result of the different tax and accounting depreciation of an asset worth 300 euros of which 150 will reverse within 2 years. The deferred tax asset will be recognised to the extent that the reversal of the taxable temporary differences give rise to tax benefits against which deferred tax assets are applied, i.e., for the amount of 150 euros.

#### b) Negative tax bases and tax credits

A deferred tax asset will be recognised for unused tax losses and tax credits pending offset provided it is probable that future tax benefits will be generated (within a maximum period of **10 years**).

##### Example

Company M has cumulative tax losses of 1,000 euros pending offset on 31 January of year X. The tax rate applicable to the company is 30%. M considers it more than likely that it will be able to generate tax benefits in X since it has a contract which will generate fiscal benefits next year of 400 euros. The Company does not know if the contract will continue in future years, so only the conditions to partially recognise the asset for tax losses of 120 euros (30% of 400) are met.

#### 4.4.2. Re-estimate of recoverability

At each accounting close, the corporate tax manager, with the help of the projections prepared and sent by the Analysis and Investments Department, should assess whether the conditions to recognise the deferred tax assets are met at each accounting close. The book value of deferred tax assets and liabilities may change, even if the amount of the corresponding temporary differences has not changed due to a change in rates or tax regulations, a re-estimation of the recoverability of the deferred tax assets, or a change in the expected form of recovering the asset's book value.

The deferred tax, corresponding to these changes, will be recognised in the profit and loss account, except where it relates to items previously charged or credited directly to equity accounts.

#### 4.5. Valuation

Deferred tax assets and liabilities will be valued taking into account the way in which the asset is expected to be recovered or the liability cancelled and the applicable rate which is approved or about to be.

Deferred tax assets and liabilities are not updated.

##### 4.5.1. Applicable rate

In certain jurisdictions, different tax rates may exist depending on how the asset is expected to be recovered or the liability cancelled. In these cases, the Group's policy is to apply the effective tax rate at which they are expected to be recovered or settled.

##### 4.5.2. Changes of rates

If the applicable rates are changed, the value of the deferred tax should be re-estimated and its effect recorded in profit/(loss).

#### Example

Company A has a deferred tax asset of 300 euros corresponding to the difference between the accounting and tax depreciation of a fixed asset. The tax rate applicable in year X was 30%. On 21 December, a change in the applicable tax rate was approved with it increasing to 40%. At the close, the company must revalue the aforementioned liability to the new rate, recording the change of 100 euros in profit/(loss).

#### Accounting entries

To account for the change in applicable rate:

| Account | Description                      | Debit | Credit |
|---------|----------------------------------|-------|--------|
| 47X     | Assets for temporary differences | 100   |        |
| 6301    | Deferred Taxes                   |       | 100    |
|         | $(1000 \times 40\%) - 300 = 100$ |       |        |

#### 4.6. Classification and presentation

Current and deferred taxes are generally recognised in profit/(loss) unless arising from:



- A business combination
- A transaction recognised directly in equity

In which case they will be registered against goodwill or equity respectively.

#### 4.7. Items recorded in equity

The tax burden will be recorded along with the item which generated it, that is, in the case of income and expenses recognised directly in equity, its tax burden will also be recorded in equity. This is the case of adjustments to the fair value of assets available for sale, the tax burden of hedging derivatives, actuarial gains and losses, among others.

##### Example

The tax effects of the valuation adjustments from cash flow hedges will be recorded against equity, with this tax effect presented on a separate line from the statement of comprehensive income.

### 5. Other aspects

#### 5.1. Withholding of dividend taxes

In countries where there is an obligation to withhold tax on the approved dividends, it is not the taxation of the company which pays it, but rather it acts as a mere tax collector on behalf of the shareholder. These taxes are recognised therefore in the company's equity as part of the distribution to shareholders.

#### 5.2. Profit or loss on transactions between Group companies

Transactions between group companies are eliminated in the accounting consolidation process, the elimination is not complete if the two companies involved in the transaction have different applicable tax rates.

#### 5.3. Foreign currency and hyperinflation

Changes in the tax base are occasionally caused by changes in the exchange rate. As an example, UK-based Company G may conduct some transactions in Germany whose functional currency is the pound sterling. As a result, non-monetary tangible fixed assets in Germany are converted to sterling using the historical exchange rate on the transaction date. If the asset is part of a tax unit in Germany, the taxable value must be calculated at each close date by applying the closing exchange rate to the balances in euros. This exchange rate difference may generate temporary differences, the recognition criteria of which are those described in the previous sections.

The conversion differences which arise in the conversion into the presentation currency in a consolidated statement do not generate tax effects as they are neither assets nor liabilities.

In the case of companies located in hyperinflationary countries, temporary differences arise as a result of the current purchasing power adjustments applicable to the assets if the tax base is maintained at the historic unit of measurement. The differences are registered in full.

#### 5.4. Tax consolidation

Currently the group consolidates taxation in Spain and other countries (Germany, Argentina, Mexico, Netherlands, Italy, Chile, Uruguay, Belgium...).

Regarding Spain, the tax group is formed by Group companies resident in Spain and in which the shareholding is greater than 75%.

In forming a tax group, it is itself which acts as the taxable subject in all formal and material obligations, and the parent company that which represents it.



The taxable base of the group will be based on the aggregation of individual taxable bases on which adjustments resulting from the consolidation will be made.

The main peculiarities of the tax consolidation regime, which can lead to taxation lower than the aggregate of the companies which compose it are:

- The deferral of taxation on operations between the companies that make up the tax group, which will only be taken into account in the calculation of the group's tax when carried out against third parties.
- The offset of positive and negative bases obtained by different group companies.
- Application of deductions at a group level.
- The non withholding on internal dividends.

#### **5.4.1. Internal operations**

Positive and negative results arising from internal operations are eliminated from the calculation of consolidated tax, and their payment is deferred to the year in which they are realised.

#### **5.4.2. Dividends**

Internal dividends between group companies are eliminated in the calculation of consolidated tax, by way of exemption, i.e. not its taxation and the application of the corresponding deduction for double taxation.

#### **5.4.3. Portfolio provisions**

Portfolio provisions should be eliminated to avoid double deduction when the losses of the companies which form the group are included in the aggregation step of individual tax bases.

#### **5.4.4. Negative tax bases**

Negative tax bases generated by companies belonging to the tax group are offset against the positive ones in the same year; only if the consolidated tax base is negative will it be offset by positive bases in subsequent years.

#### **5.4.5. Deductions**

Deductions are applied at the group level, i.e. if the individual bases cannot absorb the allowable deductions, the excess may be applied to the group where the consolidated total share is sufficient.

### **5.5. Transfer pricing**

The Group must have the documentation required by each tax law which supports the prices at which transactions are made being market prices.

## **6. Calculation of tax in interim periods**

In interim periods, the tax expense should be calculated on the average effective tax base which is expected to apply in the full period. In the interim periods, the deferred taxes of temporary differences which are not moved to profit/(loss) are not calculated.

Likewise, the impacts of non-deductible expenses will be considered in the interim profit/(loss) calculation.